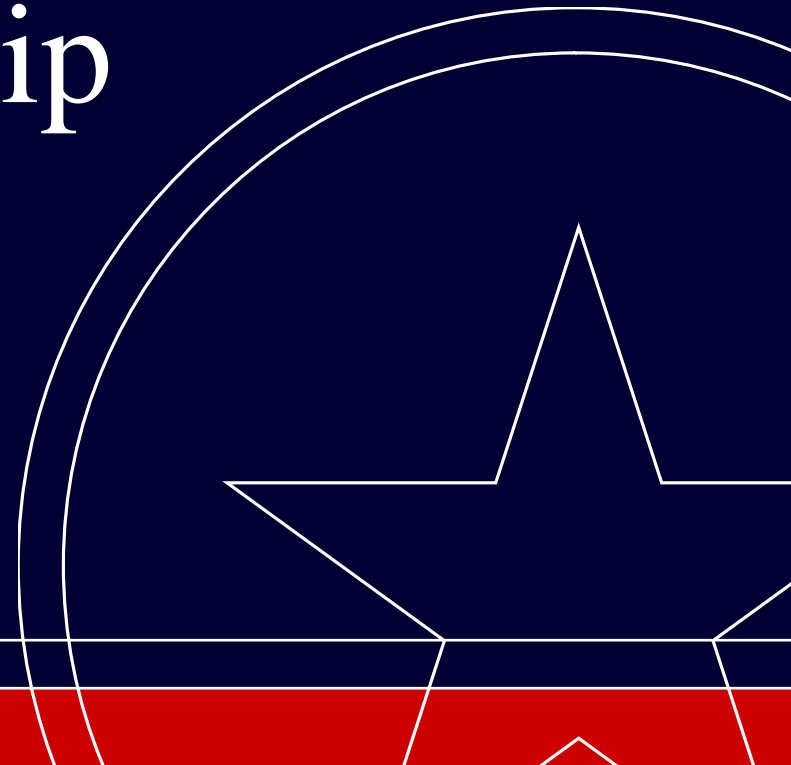




# Total Cost of ETF Ownership

Helping clients understand how to  
calculate their all-in cost structure



# Agenda

01

## **Understanding Total Cost of Ownership**

Slides 3-5

02

## **Explicit Costs**

Slides 6-10

03

## **Implicit Costs**

Slides 11-12

04

## **Opportunity Costs**

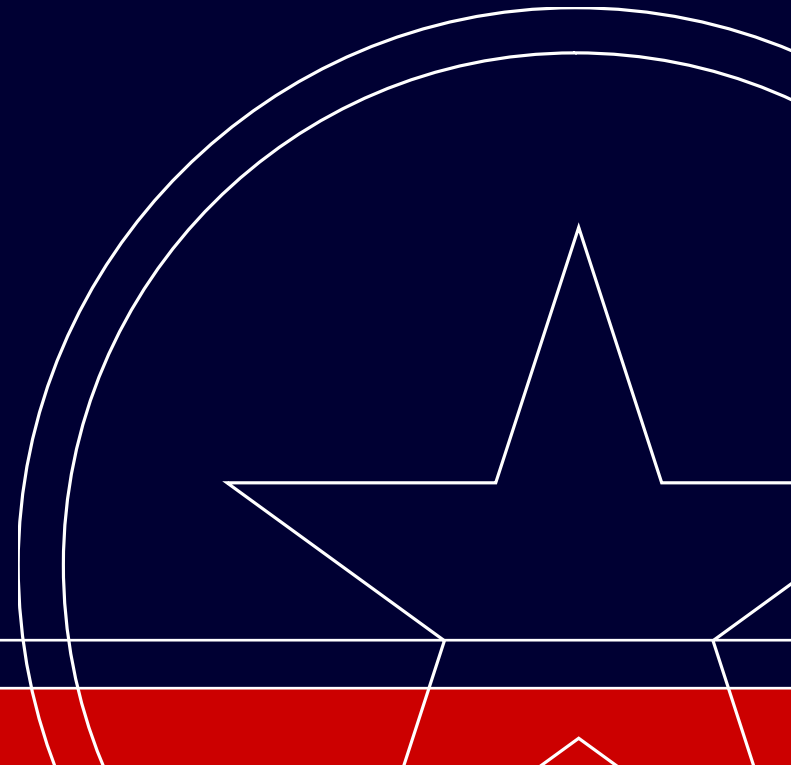
Slides 13-16

05

## **Reconsidering Rules of the Road**

Slides 17-22

UNDERSTANDING  
ETF Total Cost  
of Ownership



# Superficial Ways to Evaluate ETFs



How do clients normally evaluate costs associated with individual ETFs?

**C**

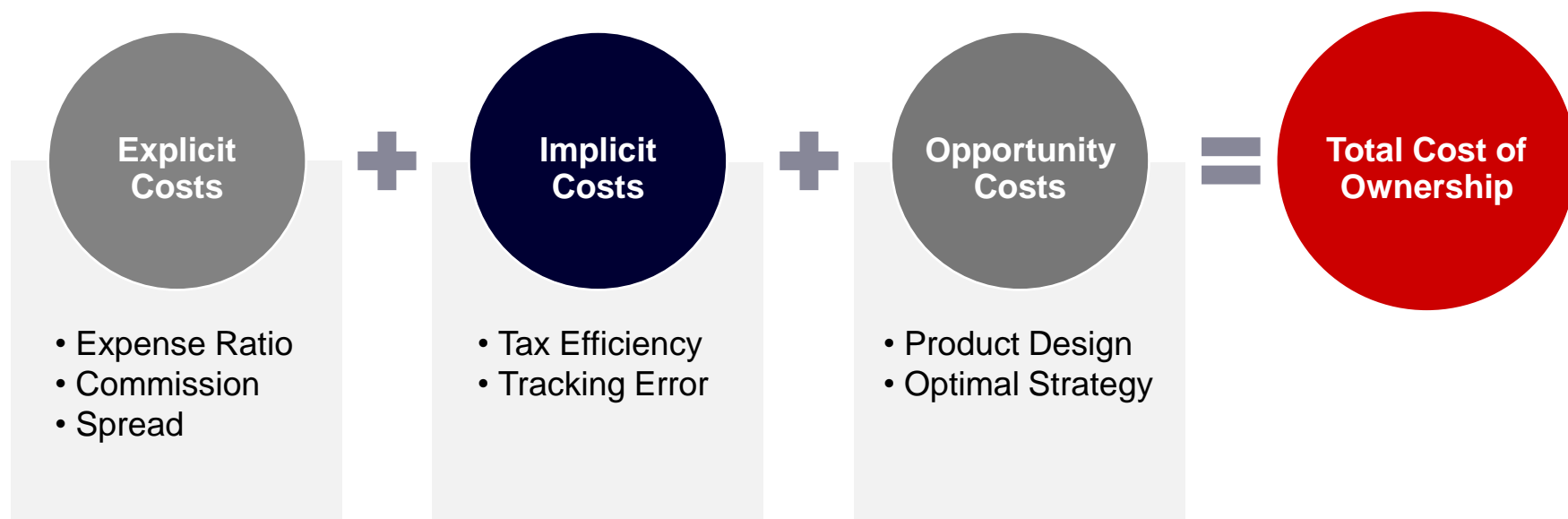
**COSTS:** What is the expense ratio?

**L**

**LIQUIDITY:** How much volume trades daily?

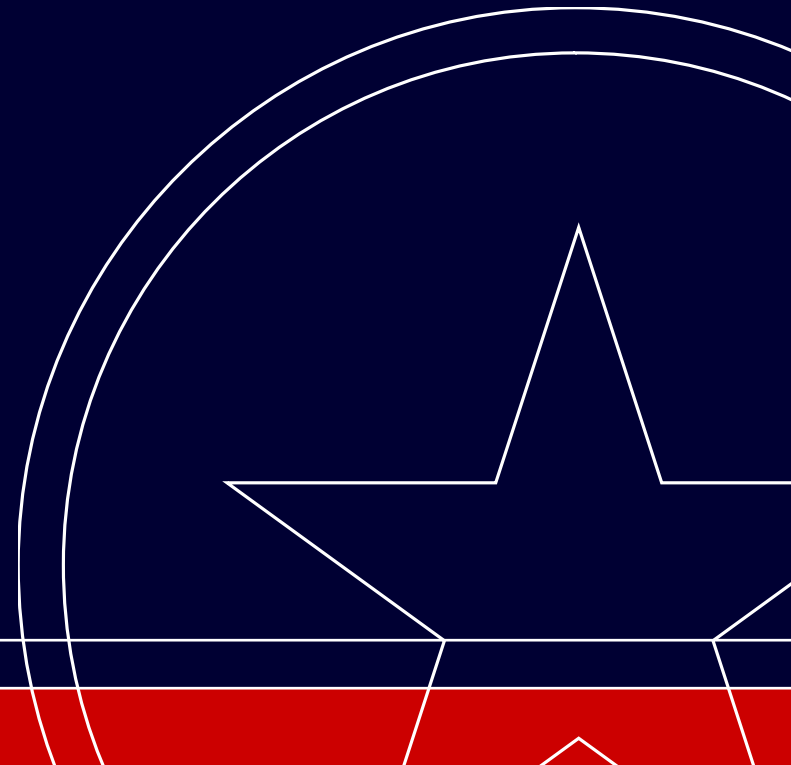
**S**

**SPREAD:** What is the difference between the offer (price to buy) and the bid (price to sell)?

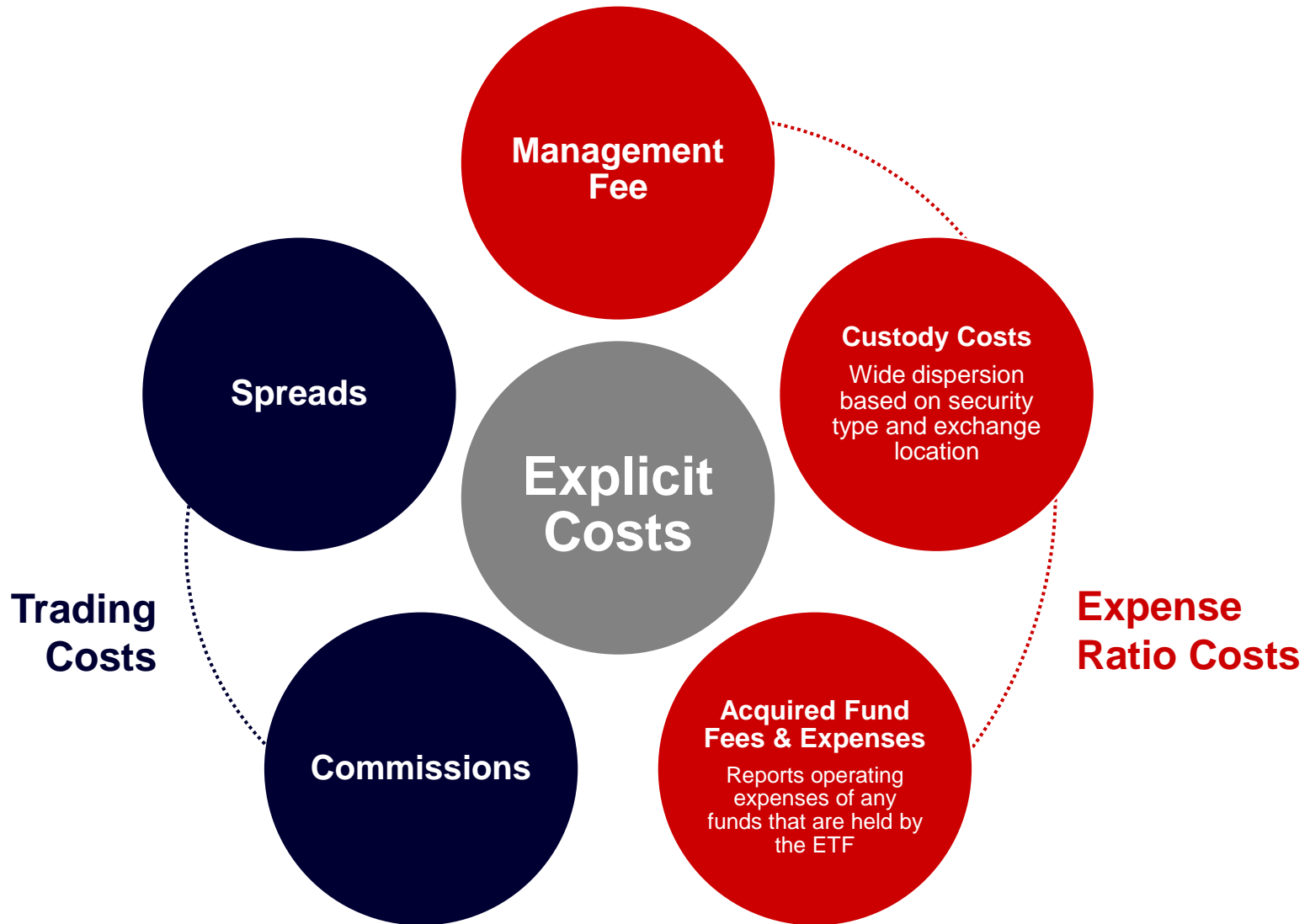


ETF

# Explicit Costs

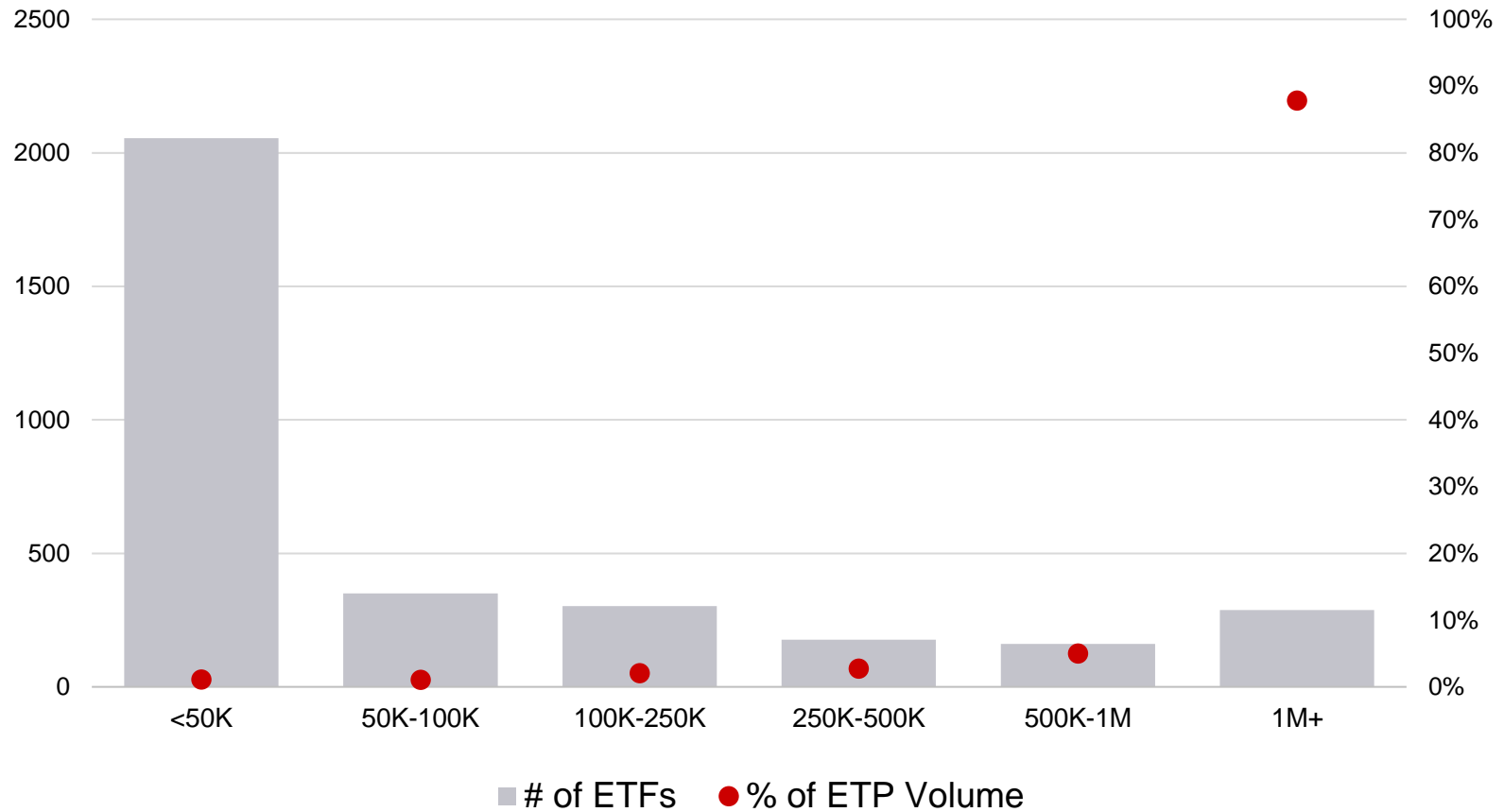


# Explicit Costs



# ETF Volume

Average Daily Volume of All ETPs | \*Volume ≠ Liquidity





# Understanding ETF Liquidity



**ETFs always have more than one level of liquidity**

## Level 1: On-Screen Liquidity

**Current Bid-Ask Spread and Size Available to trade**

Trading activity that has already transpired and is visible in the secondary market, where ETFs are priced and traded like stocks

## Level 2: Non-displayed Liquidity/Market Depth

**Market Maker's Ability to Provide Liquidity for Larger Trades**

With the assistance of a broker, this level of liquidity may be accessed.

## Level 3: Underlying Basket of Securities

**Current Bid-Ask Spread and Size Available to trade**

Market makers can access the liquidity of the underlying securities to meet investors' demand. This process is done through the Creation and Redemption Mechanism.

# Understanding ETF Liquidity



## What matters is what the ETF is holding

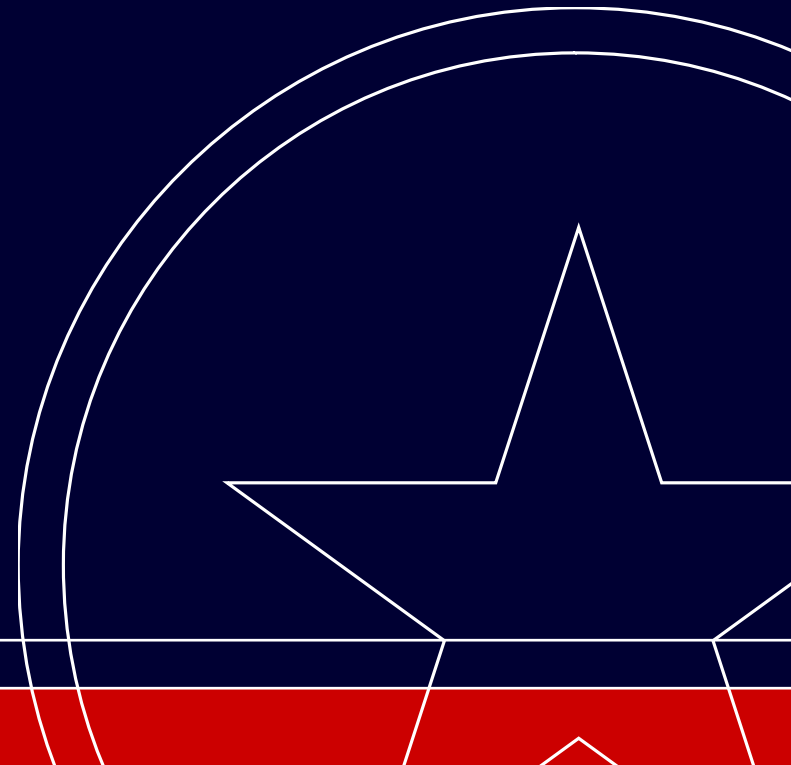
### TXS - Top 20 Holdings

As of 12/29/23

COMPANY NAME	PORTFOLIO WEIGHT	30 DAY AVERAGE DAILY TRADING VOLUME (ADTV)	COMPANY NAME	PORTFOLIO WEIGHT	30 DAY AVERAGE DAILY TRADING VOLUME (ADTV)
Tesla Inc.	4.87%	\$28,950,929,093	Cheniere Energy Inc.	2.34%	\$256,391,397
Crown Castle Inc.	3.98%	\$498,675,249	Wingstop Inc.	2.16%	\$97,175,056
CrowdStrike Holdings Inc.	3.78%	\$879,564,634	CBRE Group Inc.	2.12%	\$161,331,672
Waste Management Inc.	3.48%	\$276,953,613	Sysco Corporation	2.12%	\$226,440,828
Charles Schwab Corporation (The)	3.43%	\$767,461,386	Academy Sports & Outdoors Inc.	1.96%	\$128,043,300
McKesson Corporation	3.36%	\$443,694,568	GameStop Corporation	1.93%	\$196,111,265
Tenet Healthcare Corporation	3.35%	\$80,669,312	Service Corp International	1.87%	\$63,128,560
Digital Realty Trust Inc.	3.24%	\$300,904,596	Oracle Corporation	1.84%	\$1,376,024,283
Exxon Mobil Corporation	2.83%	\$2,317,688,170	ConocoPhillips	1.80%	\$838,849,032
DR Horton Inc.	2.49%	\$438,690,878	Quanta Services Inc.	1.73%	\$235,776,606

ETF

# Implicit Costs



# Implicit ETF Costs



Portfolio Manager  
**Controls** these Costs

Costs **NOT** Controlled by  
the Portfolio Manager

**Capital Gains** →

**Turnover** →

**Tracking Error** →

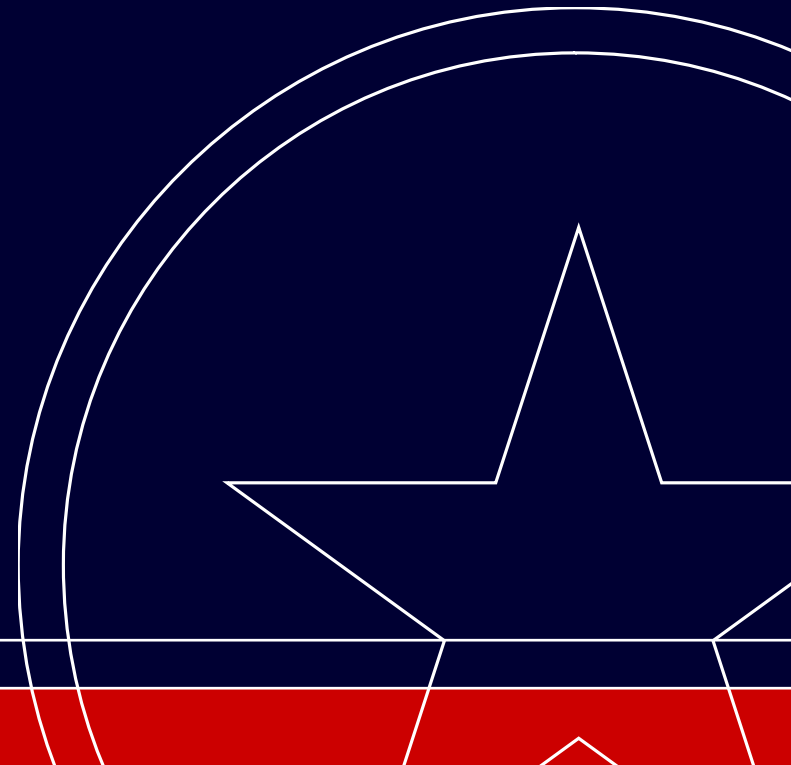


← **Distribution Fees**

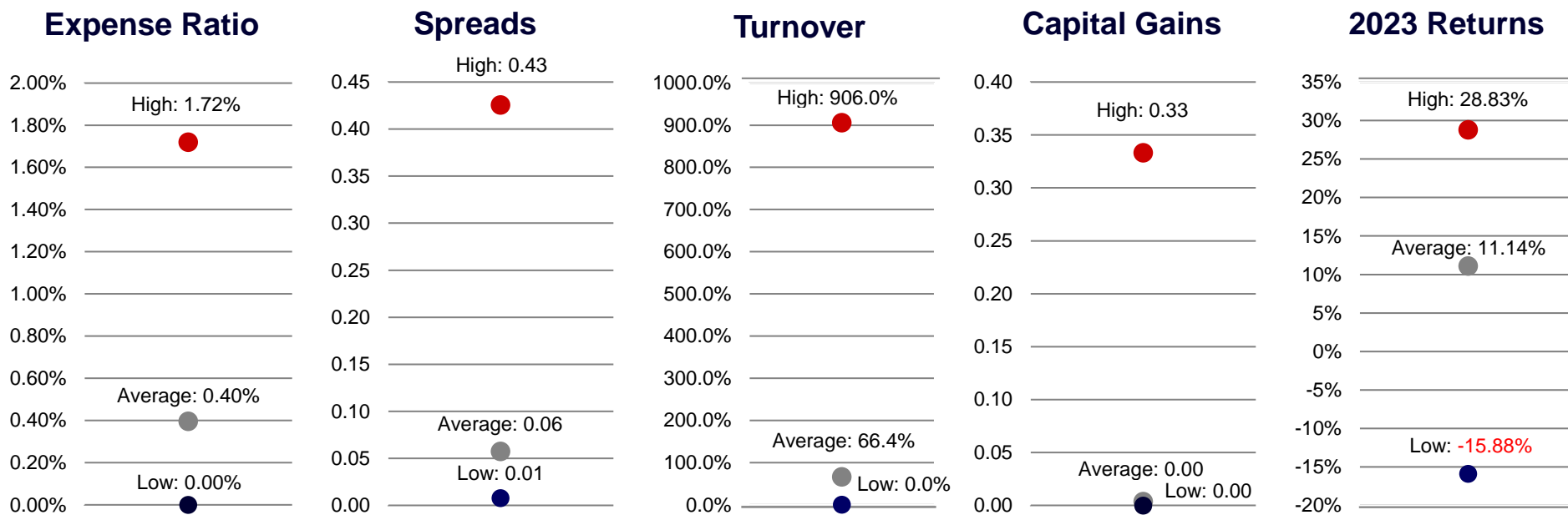
← **Realized Gains**

ETF

# Opportunity Costs



# ETFs that Appear the Same Can Behave Differently



## Morningstar Large Cap Value Category

Difference between highest and lowest observation for each characteristic

172 bps

42 bps

906%

.33

44.71%

Source: Morningstar Direct. Data reflects performance from 1/1/23 to 12/31/23 for the 118 ETFs included in the Large-Cap Value for the full year 2023. Only 2 ETFs of the 118 distributed capital gains in 2023. Past performance is no guarantee of future results.



## Opportunity Cost in a Nutshell

How an ETF delivers exposure and its implications for performance over time.

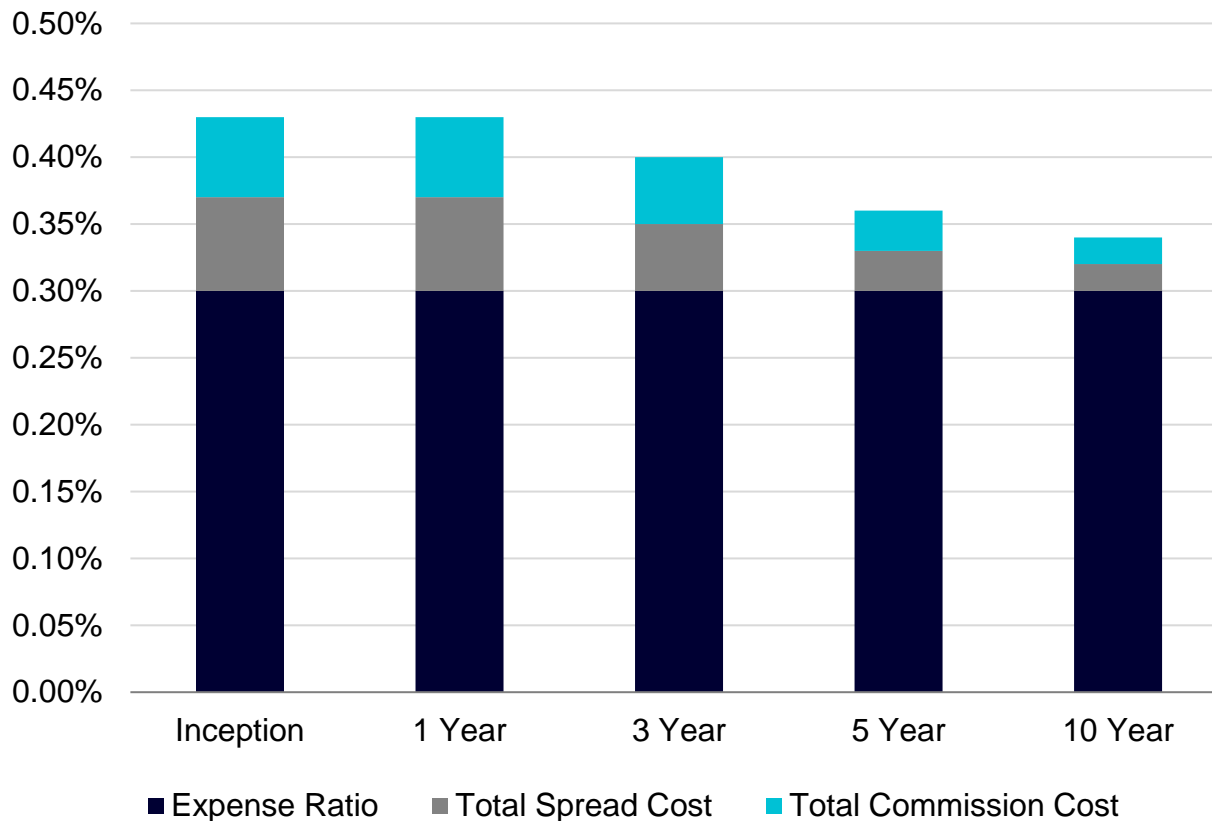
**Critical elements can easily overshadow low management fees and impose unintended consequences on investors**

Is the index replicated or sampled?	Are there sector concentrations?
Are there geographic over-concentrations?	How does the fund gain international exposure: ADRs, GDRs, futures or local stocks?
How are currency exposures managed?	How does the manager balance turnover, capital gains and index tracking?

# The Impact of Time



## Explicit Costs Are Reduced Hypothetical Example – XYZ Fund

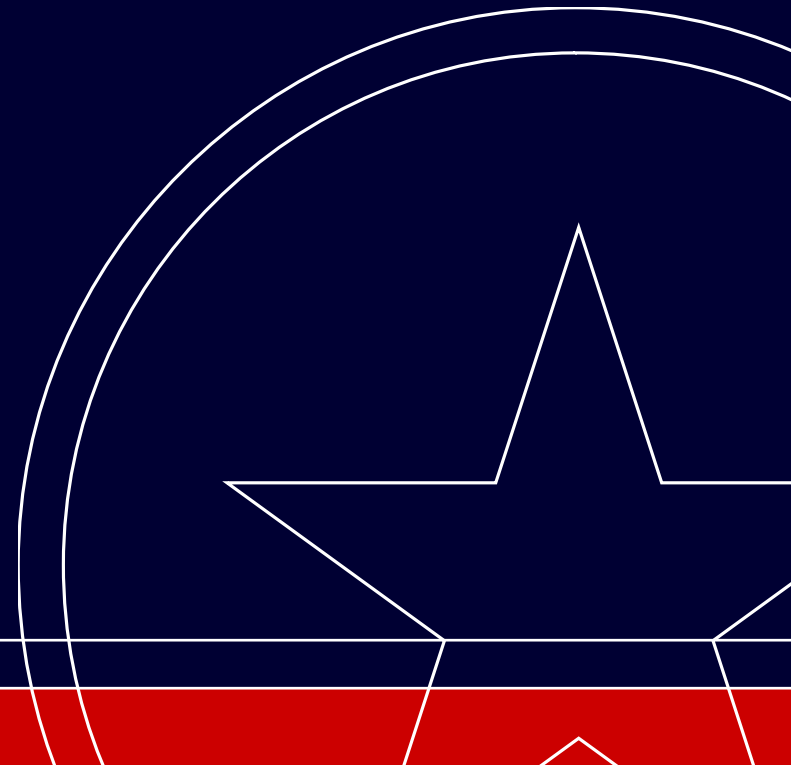


- \$100,000 total investment with average \$5 commission per trade.
- Market price assumes an average annual return of 8% over the appropriate time frame.
- Spread \$0.05



RECONSIDERING

# Rules of the Road



# Redefining Rules of the Road



**Broadly accepted “rules of the road” have sought to simplify the screening process.**

**These rules suggest that high trading volume, low fees and low portfolio turnover are generally more desirable.**

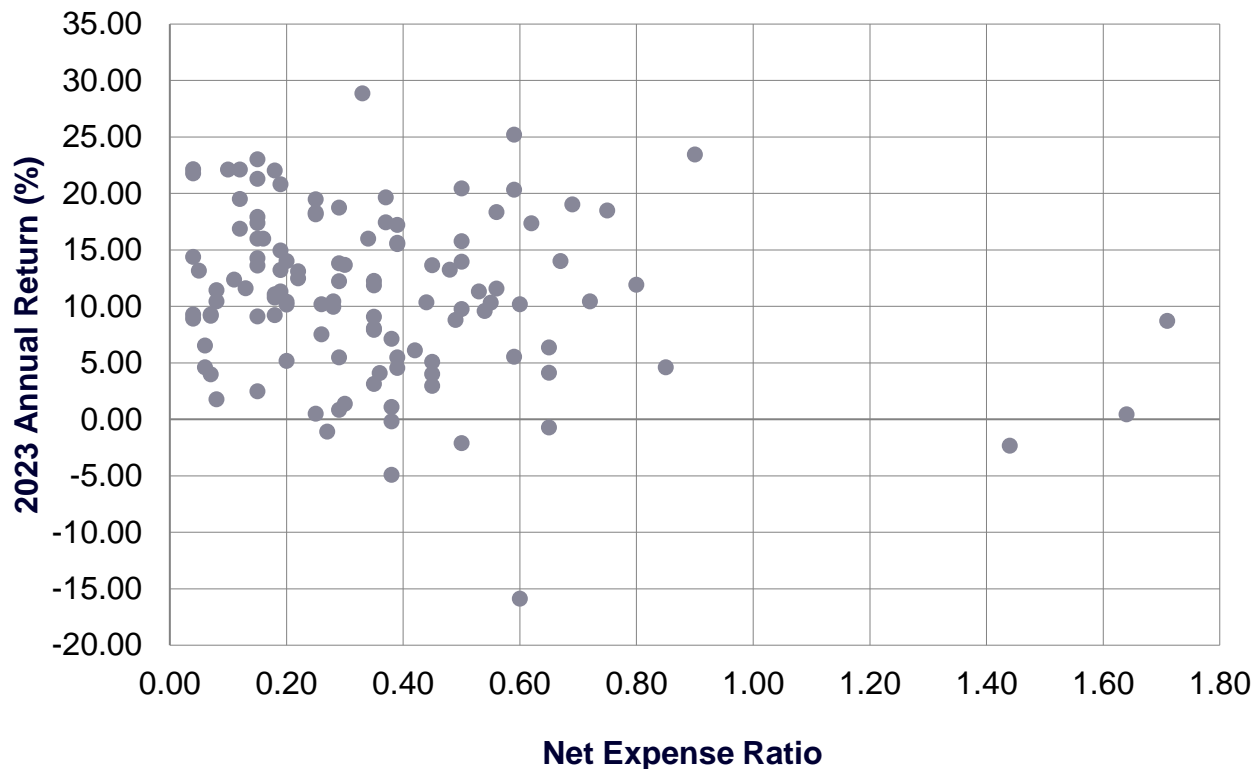
**Our findings suggest a new rule of the road:**

***“Look under the hood to more thoroughly assess ETF options.”***



## EXPENSE RATIOS VS. RETURNS

*Little Discernible Relationship*



- Focus on net-of-fees returns.
- Look closely at how a given ETF is delivering the exposure it aims to provide.

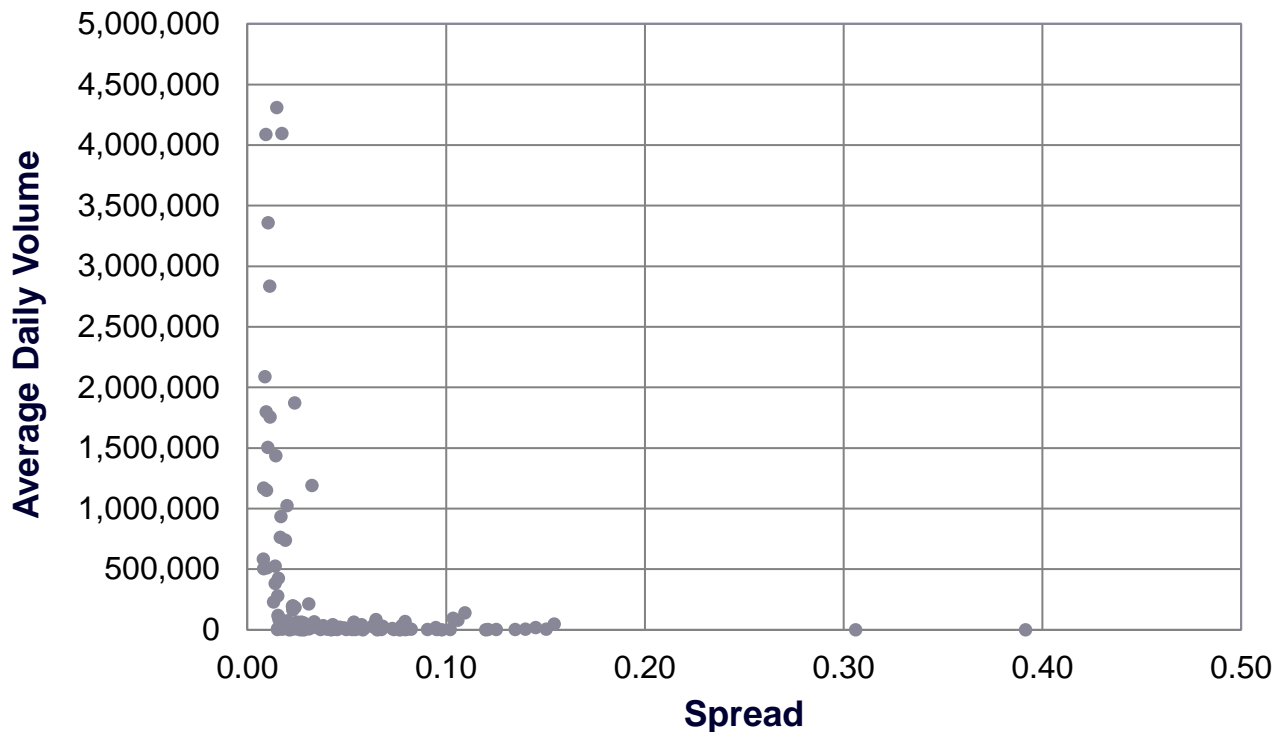
Source: Morningstar Direct. Data reflects performance from 1/1/23 to 12/31/23 for the 118 ETFs included in the Large-Cap Value for the full year 2023.

# Higher Average Daily Volume Means Tighter Spreads



## SPREADS & TRADING VOLUME

*Little Historical Relationship Between the Two*



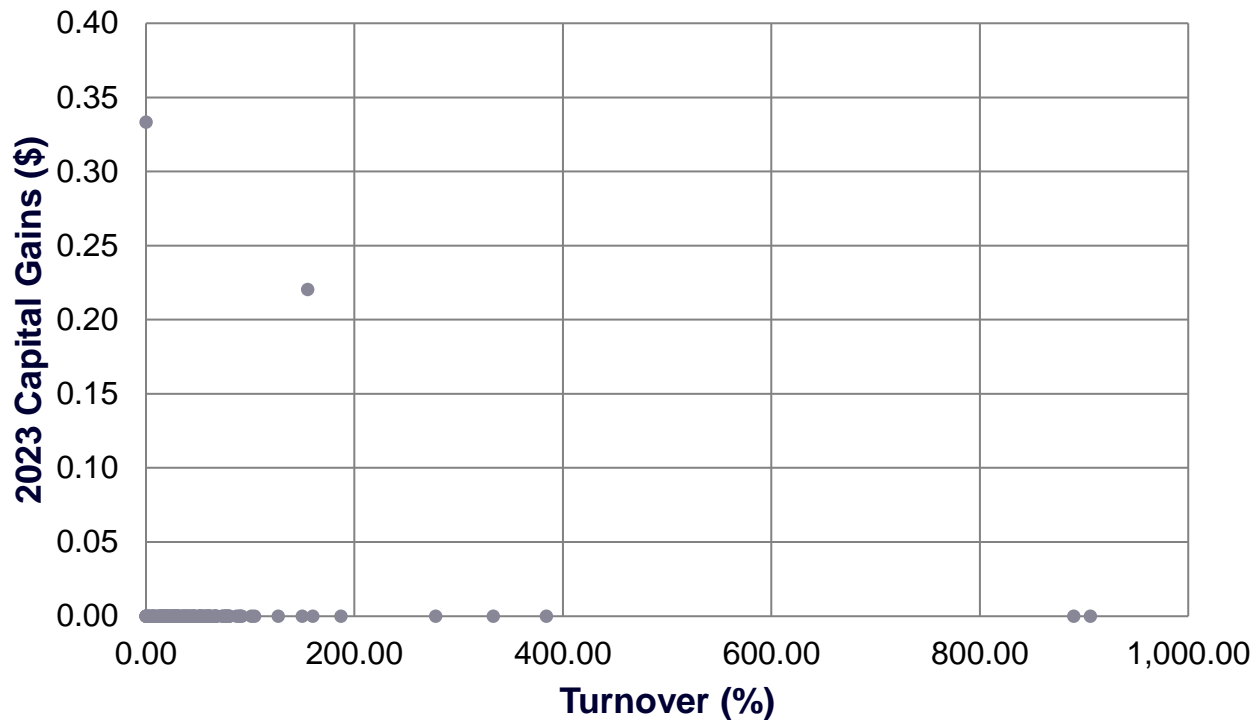
- Even with low trading volumes, most ETFs delivered tight spreads.
- Tight spreads help keep costs lower for investors.

Source: Morningstar Direct. Data reflects performance from 1/1/23 to 12/31/23 for the 118 ETFs included in the Large-Cap Value for the full year 2023.



# High Turnover Means higher Capital Gains Exposure

## HIGH TURNOVER HAS NOT EQUATED TO HIGH CAPITAL GAINS



- Look beyond turnover for a more accurate understanding of capital gains exposure.

Source: Morningstar Direct. Data reflects performance from 1/1/23 to 12/31/23 for the 118 ETFs included in the Large-Cap Value for the full year 2023.

# Total Cost of Ownership



## Expense Ratio

Where does focusing on this make the most sense?

Should take a backseat to investment strategy



## Investment Strategy

Fit within the client's risk framework and investment objective

Efficiently gain exposure to the intended asset class and strategy

Unintended biases or uncompensated risk factors



## Product Structure

Product design

Exposures to markets

Security types represented



## Portfolio Management

Index replication, active or sampling

Capital gains and distributions

Portfolio turnover



***This information is for educational use only and not intended to serve as investment or tax advice.***

This material has been prepared for educational purposes only. It is not intended to provide, and should not be relied upon for, investment, accounting, legal or tax advice. Material presented has been derived from industry sources considered to be reliable, but their accuracy and completeness cannot be guaranteed.

Investment return and principal value of security investments will fluctuate. The value at the time of redemption may be more or less than the original cost. Past performance is no guarantee of future results.

**Exchange Traded Funds (ETF) are bought and sold through exchange trading at market price (not NAV), and are not individually redeemed from the fund. Shares may trade at a premium or discount to their NAV in the secondary market. Brokerage commissions will reduce returns.**

***You should consider the fund's investment objectives, risks, and charges and expenses carefully before you invest. The fund's prospectus or summary prospectus, which can be obtained at <https://www.texascapitalbank.com/etf-funds-management>, contains this and other information about the fund, and should be read carefully before investing.***

17870326-NLD-02/09/2024



Thank you

