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An Introduction to ETFs

Exchange-Traded Funds

2nd Quarter 2020

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What is an ETF?

Exchange traded funds (ETFs) are funds that trade like stocks; they can be bought or sold throughout the day on a stock exchange at a market-determined price.

The majority of ETFs are index based; they are designed to track the performance of a designated index.

ETFs are typically a pooled investment vehicle that can be a basket of stocks, bonds or other investment products. ETFs can be broadly diversified or narrowly focused.

Some ETFs are actively managed; where typically the portfolio manager of an ETF selects investments to meet a particular investment objective or policy to outperform a selected benchmark. An investor can potentially purchase an ETF at, above or below the net asset value (NAV).

How It All Started

In response to the 1987 crash referred to as “Black Monday”, the SEC wrote an 840-page report which called for a new product that would be a basket of stocks and traded like one as well.

Nathan Most and Steven Bloom of the AMEX exchange read the report and came up with the idea of the creation and redemption process for their new “spider”

In 1993, SPDR® (Spider) S&P 500 ETF, (ticker symbol: SPY) was the first ETF brought to market. As of June 2020, SPY was roughly 6.26% of the entire ETF universe, with net assets of about $274 billion.

Today SPY is the largest and most actively traded exchange-traded fund on the market. Because of ETFs unique characteristics they have grown considerably among investors and advisors alike. As of June 2020 there were over 2,400 ETFs traded on the market with over $4.38 trillion in assets.

ETF Governance

An ETF can either be registered as an open-end investment company or as a unit investment trust under the Investment Company Act of 1940. Although a majority of ETFs fall under these two categories, there are some exchange traded products referred to as ETPs, that are not registered under the 1940 Act. One example of this structure is a grantor trust. An example of a grantor trust is SPDR Gold Shares (Ticker symbol: GLD). This trust's objective is for shares of GLD to reflect the performance of the price of gold bullion, less the trust's expenses.

Today, the seven different types of legal structures for ETF's are as follows:

1) Open-end funds (IVV)
2) Unit Investment Trusts (SPY)
3) Grantor Trusts (GLD)
4) Exchange-traded notes (AMJ)
5) Partnerships (BNO)
6) C-Corporations (MLPA)
7) Exchange-traded managed funds (EVSTC)

ETFs are not suitable for all investors. An investor's investment objectives and the characteristics of a particular ETF should be considered before investing. Investors should carefully review the prospectus and fully understand the risks before investing in an ETF.

Characteristics of ETFs

Diversification — Owning an ETF allows investors to have exposure to a basket of securities through a single investment.

Low Expenses — ETFs traditionally have lower annual expense ratios than those for corresponding mutual funds.

Tax Efficiency —An ETFs unique structure allows it to lessen and/or avoid capital gain distributions through an in-kind redemption process. This means that an ETF may deliver specified portfolio securities to Authorized Participants who are redeeming Creation Units instead of selling portfolio securities to meet redemption demands, which could otherwise result in taxable gains to the ETF. Oppenheimer does not provide tax advice; for questions regarding the tax implications of investments in specific ETFs and their consequences investors should consult their tax advisor.

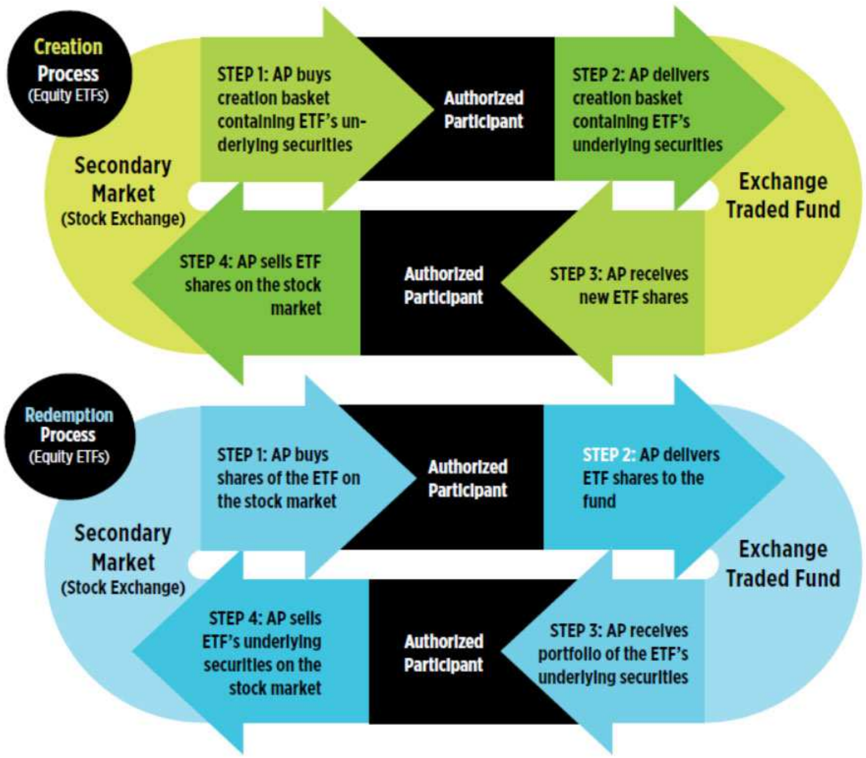
Flexibility — ETFs can be purchased or sold during any part of the trading day. Any ETF carries the same flexibility as an individual stock. This allows investors to place limit orders, buy on margin, or sell short.

Transparency — Investors can usually know what they purchase. Often, holdings of ETFs are listed on a daily basis, whereas mutual funds generally release their holdings quarterly. The transparency of the ETF's portfolio may allow investors to easily obtain or hedge exposure to a specific group of securities.

Non-Traditional ETFs (e.g., Leveraged and Inverse ETFs) — Non-traditional ETFs such as Leveraged and Inverse ETFs are different from the traditional variety of ETFs. Leveraged ETFs seek to deliver multiples of the performance of the index or benchmark they track. Inverse ETFs (also known as "short" funds) seek to deliver the opposite of the performance of the index or benchmark they track. Non-traditional ETFs such as Leveraged and Inverse ETFs are highly complex financial instruments that are typically designed to achieve their stated objectives on a daily basis. These products are not suitable for all investors and contain risks not offered by traditional ETFs. Investors should fully understand these products and be able to withstand their risks before investing. For further information please refer to the links found on slide 15.

Creation & Redemption Process

ETFs have a unique feature typically referred to as the creation and redemption process. The initial step occurs when the ETF sponsor enters into a contractual relationship with one or more large financial institutions known as an Authorized Participant. Once established, the AP will maintain supply and demand of the ETF in the market place by creating and redeeming new and old shares through the fund. This process is why ETF's rarely pass on capital gains to their shareholders when compared to a mutual fund that normally does. Please note there can be no assurance that an active trading market for shares of an ETF will develop or be maintained.



Picture Source: ETF.com

ETFs vs. Mutual Funds vs. Closed-End Funds

	ETFs	Mutual Funds	Closed-End Funds
Buying & Selling	An ETF (Exchange-Traded Fund) is a pooled investment vehicle with shares that can be bought or sold throughout the day on a stock exchange at a market-determined price	All shareholder orders receive the same daily price—NAV—calculated at 4:00 p.m. Eastern time.	A CEF (Closed-End Fund) trades on a stock exchange and can be purchased at either a substantial discount or premium to their NAV
Tax Efficiency	ETF's may deliver specified portfolio securities to Authorized Participants who are redeeming their shares, which could otherwise result in taxable gains to the ETF.	When investor redemptions are not offset by cash inflows from investors, the redemptions can trigger portfolio trading, which may have tax implications for shareholders.	The fund has the choice to include Return of Capital in its distributions on unrealized gains that can defer tax liabilities for its investors and lower their cost basis
Early Withdrawal Penalties	No	Potentially	No
Option Contracts Available	Yes	No	No
Transparency	ETFs in most cases will disclose their holdings daily.	Required to report holdings quarterly within 60 days of the period-end date	Required to report holdings quarterly within 60 days of the period-end date

Common ETF Terminology

Passive — These ETFs are the most common. Their goal is to replicate an underlying index as accurately and efficiently as possible. They are typically low cost and flexible vehicles for use in portfolio construction and model-building.

Actively Managed — As a security registered with the SEC, the goal of this type of ETF is to outperform their benchmark by finding price discrepancies in the market. It is typically more expensive than passive ETFs (with bond ETF's being the largest asset class to have this structure). Although they do not need to adhere to the weightings of an index, actively managed ETFs can report their underlying holdings daily or quarterly depending on their SEC approval application.

Transparent — These ETFs disclose their holdings and weightings every day, providing insight on the manager's ability to track an index or strategy the manager is using to generate alpha.

Non-Transparent — Introduced in 2019, Non-transparent ETFs allow the fund company to disclose its weightings on a quarterly basis as opposed to the daily, transparent ETF disclosures. This allows the fund to maintain its strategy as intellectual property. This is safeguarded by the Authorized Participant Representative who is independent of the AP and the fund itself.

Semi-Transparent — Also introduced in 2019, Semi-Transparent ETFs have a different approach to both Transparent and Non-Transparent ETFs. Being actively managed, these funds have a "proxy portfolio" (see definition below) of their underlying holdings published every day. This proxy portfolio is maintained by the AP Representative and typically has an 80-90% overlap to the fund's actual strategy. The proxy portfolio is used in order to complete the creation and redemption process.

Passive vs. Active

	Passive	Active
Objective	Replicate the underlying benchmark as consistently and cost efficient as possible	Outperform the underlying benchmark in order to create alpha for shareholders
Cost/Expense	Top 100 AUM Avg. Expense Ratio = 0.158	Top 100 AUM Avg. Expense Ratio = 0.565
Transparency	Daily	Daily but can be quarterly if deemed 'non-transparent'
Option Contracts Available	Yes	No

Data Source: Morningstar Direct

Potential Ways to Use ETFs

- To build a diversified portfolio whether conservative, moderate, aggressive, or a combination of
- To build a core strategy to a portfolio
- To add satellite holdings to a portfolio
- To add income strategies to a portfolio
- To implement a buy-and-hold strategy
- To invest in a broad investment category

Analyzing ETFs:
Your ETF Checklist

Identify what the ETF objectives and goals are. Confirm if they align with your strategic allocation plan.

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Determine if the risks associated with a particular ETF are within your tolerance for risk.

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Identify if the ETF is Passive or Active along with the type of ETF governance for tax purposes

↓

Identify the holding period for the strategy and the relevant fees/expenses that are associated with the ETF's being screened. How often does it distribute Capital Gains?

↓

Identify net assets of the ETF. Is the ETF trading at a premium or discount?

↓

Be aware of the trading volume of the ETF you are purchasing. It is advised to use a marketable limit or limit when placing an order, especially illiquid securities.

EXCHANGE TRADED PRODUCTS RISK DISCLOSURE

Exchange Traded Funds (ETFs) are subject to market risk, including the loss of principal. The value of any ETF and thus the portfolio that holds an ETF will fluctuate with the value of the underlying securities in the ETF reference basket. ETFs trade with the same brokerage commissions associated with buying and selling equities unless trading occurs in a fee-based account. ETFs often trade for less than their net asset value.

Investors and their advisors should consider an ETF's investment objective, risks, charges, and expenses carefully before investing. An ETF's prospectus, which contains this and other important information, is available from the ETF and should be read carefully by the Financial Advisor/Financial Consultant and the investor before investing.

Not all ETFs are diversified and certain ETFs contain significant concentration risks. Diversification does not ensure a profit and does not protect against loss in declining markets. Investors should refer to the individual ETF prospectus for a more detailed discussion of the specific risks and considerations for an individual ETF.

ETFs may have underlying investment strategy risks similar to investing in commodities, bonds, real estate, international markets or currencies, emerging growth companies, or specific sectors. When investing in bonds, it is important to note that as interest rates rise, bond prices will fall. Due to their narrow focus, sector-based investments typically exhibit greater volatility. There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries. When investing in real estate companies, property values can fall due to environmental, economic, or other reasons, and changes in interest rates can negatively impact the performance. The risk of loss in trading commodities and futures can be substantial. The high degree of leverage that is often obtainable in commodity trading can work against the investor as well as for the investor. You should therefore carefully consider whether such trading in ETFs is suitable for your client in light of his/her financial condition.

Nothing in this literature constitutes legal, accounting or tax advice. Since the levels and bases of taxation can change, any reference in this report to the impact of taxation should not be construed as offering tax advice on the tax consequences of investments. As with any investment having potential tax implications, clients should consult with their own independent tax adviser.

EXCHANGE TRADED PRODUCTS RISK DISCLOSURE

Exchange Traded Products (ETPs) are types of securities that derive their value from a basket of securities such as stocks, bonds, commodities or indices, and trade intra-day on a national securities exchange. Generally, ETPs take the form of Exchange Traded Funds (ETFs) or Exchange Traded Notes (ETNs).

ETFs are open-end investment companies or unit investment trusts (UITs) whose shares represent an interest in a portfolio of securities.

ETNs are senior unsecured debt obligations of an issuer, typically a bank or another financial institution; however, ETNs are not categorized as typical fixed income products.

Non-Traditional ETPs - Non-traditional ETPs employ sophisticated financial strategies and instruments, such as leverage, futures, and derivatives, in pursuit of their investment objectives. Leveraged and inverse ETPs are considered risky. The use of leverage and inverse strategies by a fund increases the risk to the fund and magnifies gains or losses on the investment. You could incur significant losses even if the long-term performance of the underlying index showed a gain. Typically, these products have one-day investment objectives, and investors should monitor such funds on a daily basis. Non-traditional ETPs are generally categorized as leveraged, inverse, or leveraged-inverse: Retail clients seeking to enter new transactions in Leveraged and Inverse Exchange Traded Funds, including options thereon ("Leveraged ETFs"), will require pre-qualification and only unsolicited orders may be accepted. Pre-qualification is required for all retail clients (including retail DVP accounts) except for those retail client accounts that are managed by an outside money manager. All accounts managed by Firm (or affiliate) employees such as Alpha, Omega, FAM and OIA are restricted from entering any opening Leveraged ETF transactions and must take appropriate measures to close or transfer any existing positions. ETFs that are not considered leveraged or inverse are not affected by this policy; thereby, they do not require pre-qualification and transactions may be solicited.

Leveraged - Uses financial derivatives and debt to multiply the returns of an underlying index, commodity, currency, or basket of assets. Leveraged ETPs may include the terms "double," "ultra," "triple," or similar language in their security name/description.

Inverse - Uses various derivatives to seek to profit from the decline in the value of an underlying index, commodity, currency, or basket of assets; used typically to hedge exposure to downward markets. Inverse ETPs may include the term "contra," "short," or similar language in their security name/description.

Leveraged-Inverse - Uses swaps, futures contracts, options, and other derivative instruments to seek to achieve a return that is a multiple of the opposite performance of the underlying benchmark or index. Leveraged-inverse ETPs may include a combination of leveraged and inverse terms such as "ultra short" in their security name/description.

The Financial Industry Regulatory Authority (FINRA) and the Securities and Exchange Commission (SEC) seek to warn retail investors of the risks associated with investing in non-traditional ETFs and issued an Investor Alert entitled "Leveraged and Inverse ETFs: Specialized Products With Extra Risks for Buy-and-Hold Investors," which is available on FINRA's and the SEC's web sites.

EXCHANGE TRADED PRODUCTS RISK DISCLOSURE

Investors who choose to invest in non-traditional ETPs should be aware of the risks, some of which are outlined below:

Non-traditional ETPs are complex products that have the potential for significant loss of principal and are not appropriate for all investors. **Investors should consider their financial ability to afford the potential for a significant loss.**

Non-traditional ETPs seek investment results for a single day only. The effect of compounding and market volatility could have a significant impact upon the investment returns. **Investors may lose a significant amount of principal rapidly in these securities.**

Non-traditional ETPs may be volatile under certain market conditions. **Investors holding non-traditional ETPs over longer periods of time should monitor those positions closely due to the risk of volatility.**

Non-traditional ETPs are focused on daily investment returns, and their performance over longer periods of time can differ significantly from their stated daily objective. **Investors may incur a significant loss even if the index shows a gain over the long term.**

Non-traditional ETPs use a variety of derivative products in order to seek their performance objectives. **The use of leverage in ETPs can magnify any price movements, resulting in high volatility and potentially significant loss of principal.**

Non-traditional ETPs may suffer losses even though the benchmark currency, commodity, or index has increased in value. **Investment returns of non-traditional ETPs may not correlate to price movements in the benchmark currency, commodity, or index the ETP seeks to track.**

Some non-traditional ETPs may have a low trading volume, which could impact an investor's ability to sell shares quickly.

Non-traditional ETPs may be less tax efficient than other ETPs. As with any potential investment, an investor should consult with his or her tax advisor and carefully read the prospectus to understand the tax consequences of non-traditional ETPs.

The specific risks associated with a particular ETP are detailed in the fund's prospectus. Additional risks may include adverse market condition risks, investment strategy risk, aggressive investment techniques risk, concentration risk, correlation risk, counterparty risk, credit risk and lower-quality debt securities risk, energy securities risk, equity securities risk, financial services companies risks, interest rate risk, inverse correlation risk, leverage risk, market risk, non-diversification risk, shorting risk, small and mid cap company risk, tracking error risk, and special risks of exchange traded funds, among others. **Investors should refer to the ETP's prospectus to obtain a complete discussion of the risks involved in that ETP before investing.**

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