

First Trust Exchange-Traded Funds



An Investor's Guide

- Investment Strategies
- Risk Management
- Tax Management

ETFs

Exchange-Traded Funds (ETFs) provide an efficient and simple way to invest in worldwide markets. ETFs offer investors the opportunity to buy and sell an entire basket of securities with a single transaction throughout the trading day. ETFs are built like an index fund, but trade like a stock. They are generally designed to track a specific index and offer investors the advantages of lower costs and improved tax efficiency over traditional, actively-managed mutual funds.

Indexing has moved beyond the S&P 500 — tracking a wide variety of sector-specific, country-specific and broad-market indexes. Since the first ETF was introduced in 1993, the industry has grown significantly. ETFs invest in a variety of assets, including large company stocks, small company stocks, international stocks, real estate investment trusts, and many more asset classes. ETFs offer a simple way for investors to allocate long-term investments in the market performance of industry leaders.

ETFs can be an effective tool for implementing many investment strategies for all types of investors. They allow individual investors to obtain the economies of scale that large fund managers enjoy, which the average person would not be able to produce with a small amount of capital. They are easy to obtain, easy to track, inexpensive, and tax efficient.

How do ETFs Compare?	ETFs	Stocks	Index Funds
Tax Efficient	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Low Expenses	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Low Investment Minimums	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Intraday Liquidity	<input type="checkbox"/>	<input type="checkbox"/>	
Diversification	<input type="checkbox"/>		<input type="checkbox"/>
Fully Invested	<input type="checkbox"/>	<input type="checkbox"/>	Possible
Portfolio Transparency	<input type="checkbox"/>	<input type="checkbox"/>	Possible
Ease of Ownership	<input type="checkbox"/>		<input type="checkbox"/>
Able to Sell Short	<input type="checkbox"/>	<input type="checkbox"/>	
Able to Buy on Margin	<input type="checkbox"/>	<input type="checkbox"/>	
Able to Use Limit and Stop Orders	<input type="checkbox"/>	<input type="checkbox"/>	
Listed Options Available	<input type="checkbox"/>	<input type="checkbox"/>	
Ease of Dollar Cost Averaging			<input type="checkbox"/>

You should consider a fund's investment objectives, risks, and charges and expenses carefully before investing. Contact your financial advisor or call First Trust Portfolios, L.P. at 1-800-621-1675 to request a prospectus, which contains this and other information about a fund. Read it carefully before you invest.

See the back of this brochure for important disclosures.

Not FDIC Insured • Not Bank Guaranteed • May Lose Value

ETFs offer similar advantages of indexing such as low operating costs, performance designed to track an index, the potential for high tax efficiency and consistent investment strategies.

The ETF structure provides many benefits:

- **Diversification** – Owning an ETF allows investors to hold a basket of securities and have exposure across an entire index. An ETF offers the day-to-day trading opportunities of a stock with the diversification of a mutual fund. Diversification primarily helps reduce volatility and also has the potential to enhance your returns.
- **Low Expenses** – ETFs are index-based and not actively managed. Because of this, they are less likely to carry high management fees and usually have lower annual expense ratios than other investment vehicles.
- **Tax Efficiency** – The ETF’s structure allows it to substantially lessen and/or possibly avoid capital gains distributions through an in-kind redemption process. The Creation/Redemption Process allows all share activity to be facilitated through the in-kind distribution transfers with institutional investors, preventing the fund from incurring capital gains as a result of shareholder trades. However, the ETF structure does not necessarily eliminate all capital gain distributions.
- **Flexible** – Any ETF can be bought and/or sold with the same flexibility as an individual stock. This allows investors to place stop-limit orders, buy on margin, or sell short. Any of these transactions would make them subject to the same terms that would apply to individual common stocks.
- **Transparency** – Investors will know exactly what they purchase. The holdings of ETFs are listed on a daily basis, whereas mutual funds generally release their holdings quarterly. The transparency of the ETF’s portfolio allows investors to easily obtain or hedge exposure to a specific group of securities.
- **Dividend Reinvestment** – Dividends from the underlying securities are reinvested in the ETF. Any dividends paid to shareholders from the ETF may be reinvested directly, rather than receiving cash, providing your brokerage firm offers this reinvestment option.
- **Tradability** – ETFs can be purchased or sold during any part of the trading day. They are listed on an exchange, so it’s easy for investors to buy or sell shares throughout the day. Because ETFs are listed, investors can obtain up-to-the-minute share prices from their broker or financial advisor and trade the relevant index as though it were one single stock.

Investment Strategies Using ETFs

In today's financial marketplace, a well-maintained portfolio is vital to any investor's success. Investors are focusing on the fundamentals of sound investing and are realizing that "time in the market" is not the only factor that determines long-term success. Sound portfolio construction begins with aligning investment goals to appropriate investment strategies such as asset allocation, diversification, cost control and risk management and applying periodic portfolio rebalancing.

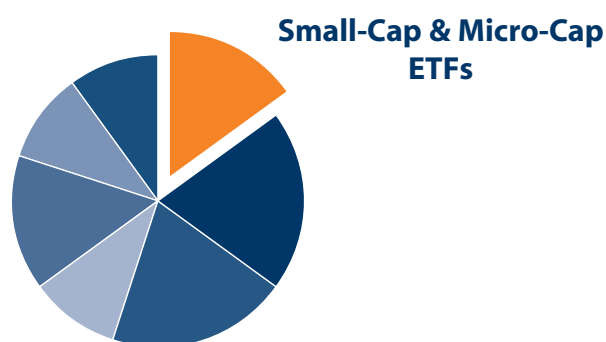
Exchange Traded Funds (ETFs) combine many of the features found in index mutual funds with the trading flexibility of individual stocks. The flexibility provided by ETFs makes these instruments one of the most useful investment tools available for both individual and institutional investors. ETFs are well-known as a tool to invest in broad-market indexes. They offer a simple way for investors to assemble a low-cost, broadly diversified portfolio of industry leaders from major global market segments. ETFs offer diversification, low expense ratios and tax efficiency in a flexible investment that can be adapted to suit a multitude of objectives. The benefits of investing in ETFs can be enhanced when using them strategically.

Asset Allocation

There are many significant considerations when constructing an investment portfolio – your current financial situation, future needs for capital and your risk tolerance to name just a few. Investors have long recognized the importance of balancing risk and creating diversification by dividing assets among major asset classes such as cash, bonds, stocks, and real estate. ETFs provide a sophisticated means to efficiently gain exposure to market segments encompassing a wide range of asset classes, market capitalizations, styles and sectors. ETFs have made it possible for all investors to build tailored investment portfolios consistent with their financial needs, risk tolerance and investment horizon. Selecting an appropriate asset allocation strategy and conducting periodic reviews may help to achieve your long-term investment goals and provide the potential for above average returns while reducing risk.

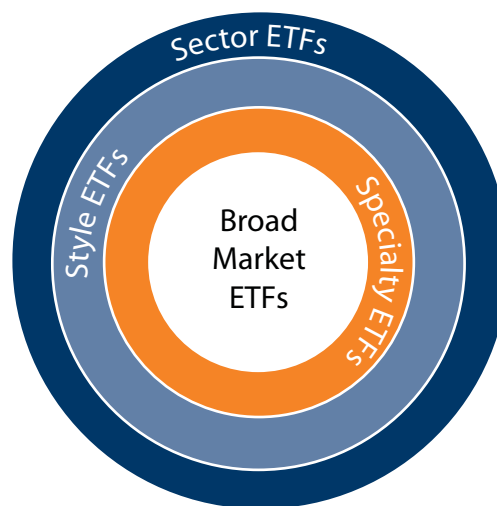
Portfolio Completion

An investor can use ETFs to fill a missing asset class in their allocation. Many portfolios might not have adequate exposure to certain sectors or market capitalization ranges. If, for example, your portfolio was underweighted in small-cap companies, you could purchase an ETF to gain the proper degree of exposure which is dictated by your asset allocation plan.



Core & Satellite Portfolio Structure

The strategy of investing in broad based assets that provide market matching returns as a core component in a portfolio, enhanced by satellite positions that are concentrated in specific market segments, has been part of investor's asset allocation plans for decades. This strategy considers your tolerance for risk and allows you to actively tailor the investments based on your specific asset allocation plan. With the wide variety of ETFs available today, investors can use ETFs effectively as both core and satellite components. Broad based ETFs can be used as the core of a portfolio and are complemented by sector, style or other specialty ETFs that are used for the satellite assets. And because of the ETF structure, investors are able to make changes easily which has a direct impact on risk management.



Risk Management

Diversification

Diversification is a risk-management practice that combines a variety of investments within a portfolio in an effort to reduce the overall volatility of the portfolio. Because ETFs provide broad exposure to an entire asset class, they can be used to efficiently mitigate the risk of being over exposed to any one company or area of the market.

Hedging

ETFs have opened up risk management strategies for individual investors that were once available only to large institutions. They can be purchased on margin and sold short, even on a downtick, providing maximum trading flexibility. Listed options are available on some ETFs and offer opportunities for additional hedging or to increase income. It is important to note that substantial risks and higher costs may result from borrowing and short-selling ETFs. These strategies may not be suitable for all investors.

Tax Management

Tax efficiency

Unlike traditional open-end mutual funds, ETF investors are not impacted by purchases and redemptions by other shareholders. The Creation & Redemption Process allows all share activity to be facilitated through the in-kind distribution transfers with institutional investors, preventing the fund from incurring capital gains as a result of shareholder trades. However, the ETF structure does not necessarily eliminate all capital gain distributions.

Creation & Redemption Process

Before discussing the process that makes an ETF more tax efficient, it is important to understand how traditional mutual funds operate. Mutual fund shareholders, either directly or through a broker, purchase and redeem shares from the fund in exchange for cash. When investors send cash to purchase shares, the fund manager can either hold the cash or purchase additional securities for the fund through the capital markets. Conversely, when investors redeem their shares, the fund manager will often have to sell securities in order to raise the cash needed to meet the redemption. This may generate a capital gain which gets passed along to the remaining shareholders of the fund. In a year where the fund experiences negative performance, investors can be particularly disappointed when they receive unwanted taxable capital gains distributions.

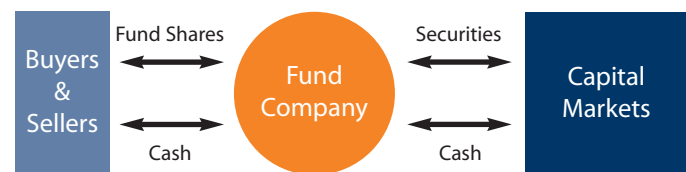
Unlike traditional mutual funds, only Authorized Participants (APs) can create or redeem ETF shares directly with the fund in very large blocks of shares called creation units. APs consist of market makers, large investors, specialists or institutional broker/dealers. To create units, the AP purchases a basket of securities, which represents the ETF's holdings, through the capital markets and delivers them to the fund custodian. In return, the custodian delivers the appropriate number of ETF shares to the AP. This transaction is done in-kind, meaning that securities are exchanged for ETF shares. Once the AP receives the ETF shares, the shares are then sold to investors on the open market just like shares of stock. Although the ETF structure does not guarantee that there will never be capital gains distributions, it is this in-kind transfer process that makes ETFs more tax efficient than their open-end fund counterparts.

Redemptions are simply the opposite of the creation process. Creation units are redeemed in exchange for the underlying securities through an in-kind transfer between an AP and the fund custodian.

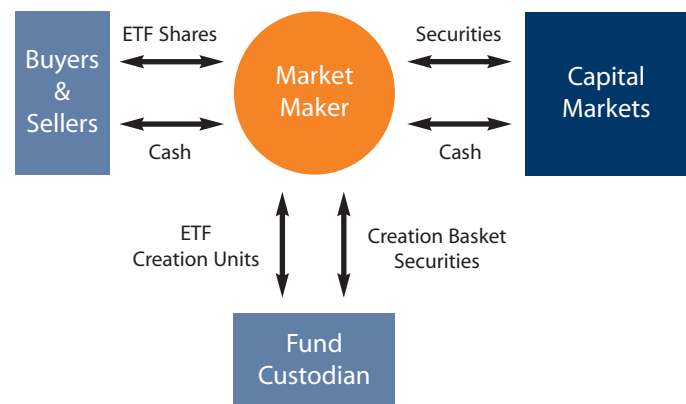
Tax loss harvesting

ETFs provide an effective way for investors to realize a tax loss while maintaining wanted exposure to a market segment. Tax-loss harvesting is a common year-end strategy of selling a stock which is at a loss and buying an ETF that closely correlates to its sector, thereby keeping portfolio allocations intact.

A Traditional Mutual Fund



An Exchange-Traded Fund



Risks

A fund's shares will change in value, and you could lose money by investing in a fund. An investment in a fund involves risks similar to those of investing in any fund of equity securities traded on exchanges. One of the principal risks of investing in a fund is market risk. Market risk is the risk that a particular stock owned by a fund, fund shares or stocks in general may fall in value.

You should anticipate that the value of the shares will decline, more or less, in correlation with any decline in the value of the index. A fund's return may not match the return of the index. A fund may not be fully invested at times. Securities held by a fund will generally not be bought or sold in response to market fluctuations and the securities may be issued by companies concentrated in a particular industry. A fund may invest in small capitalization and mid capitalization companies. Such companies may experience greater price volatility than larger, more established companies.

Investors buying or selling fund shares on the secondary market may incur brokerage commissions. Investors who sell fund shares may receive less than the share's net asset value. Unlike shares of open-end mutual funds, investors are generally not able to purchase ETF shares directly from the fund and individual ETF shares are not redeemable. However, specified large blocks of shares called "creation units" can be purchased from, or redeemed to, the fund.



1001 Warrenville Road
Lisle, Illinois 60532
1-866-848-9727
www.ftportfolios.com



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