For All the Indexers: Here Are 2 ETF Alternatives for Your Taxable Accounts

Description

Index investing has become very popular in recent years. And why not? Returns from indices such as the **S&P/TSX 500 Index** and the Nasdaq have provided investors with double or high-single-digit returns over the past several years. Many of the world's greatest investors, including Warren Buffett, encourage investors to put their money into funds such as the S&P 500 if they do not have the time or the desire to invest individual stocks.

Several of these funds have their own methods for organizing their ETF structures, making them slightly different from the rest. One interesting variation of index fund comes from Horizon Exchange Traded Funds. Two of its ETF offerings, the **Horizons S&P/TSX 60 INDEX ETF** (TSX:HXT) and the **Horizons S&P 500 INDEX ETF** (TSX:HXS) offer an interesting twist on the S&P 500 Index.

You see, these ETFs provide one advantage for taxable accounts that are not available for many other ETFs of similar structure. This ETF does not pay a dividend, making these excellent ETF holdings for a taxable account. Instead of being taxed on the dividends as you receive them, you will only be taxed on capital gains when this ETF is sold, the same as if you were holding a non-dividend paying stock. The benefits in a taxable account are quite compelling. All of your gains will be able to compound tax-free until sold.

The way this is accomplished is through a structure known as a "Total Return Swap." Essentially, Horizon enters into an agreement with a counterparty that will provide the ETF with the total return of the index in exchange for the interest earned on the cash deposit that is made with the counterparty institution. No shares are actually purchased by Horizons, it is the swap agreement that allows the ETF to mimic the returns of the Canadian (HXT) or American (HXS) indices being tracked.

In addition to being tax efficient, the ETF has another advantage. As there is no active management, the fees can be quite low as compared to many other comparable products. The HXT has a management fee of 0.03%, making it a cheap holding compared to similar ETFs. The HXS has a management fee of 0.10%. These fees are comparable to some of the lowest fees out there, especially when you factor in the tax effectiveness of the no-dividend structure.

Also, since the ETF does not actually hold any stocks, it does receive dividends from companies. Most index ETFs receive the dividends from the companies and hold it until it is paid out on a predetermined schedule. This means that much of the cash is sitting idle and is not maximized until it is paid out. The Horizon ETFs do not have the inefficient cash problem, so they have reduced tracking error as compared to a standard index ETFs.

Both the HXS and HXT are excellent ideas if you want to buy Canadian and American index ETFs for passive investing. Of course, if you are looking for income, these will not provide distributions. But the low fees, combined with the tax-friendly structure are very appealing if you are looking for an index ETF to add to your taxable portfolio.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:HXS (Horizons S&P 500 Index ETF)
2. TSX:HXT (Horizons S&p/tsx 60 Index ETF)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Investing

Date
2025/08/24
Date Created
2018/08/26
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