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FINANCIAL STEWARDSHIP LIBRARY

FS-003

# ETF INVESTING

How Wide or Narrow Do You Want Your Exposure to Be?

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# ETF Investing

FS-003 · Version 1.0

KLF KNOWLEDGE SYSTEM

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CHAPTER 1

# UNDERSTANDING THE MARKET

Before an ETF makes sense, the market itself needs a shape. That shape has four levels, each one narrower than the last:

| Level | What It Means |
|---|---|
| Market | The whole investable universe — e.g., “the U.S. stock market.” |
| Sector | A broad category of business within the market — Technology, Energy, Healthcare, Financials, and so on. |
| Industry | A narrower grouping within a sector — Technology contains semiconductors, software, hardware; Energy contains oil & gas, solar, utilities. |
| Company | A single business a reader could buy shares of directly. |

An ETF can be built at any level of this ladder — a fund tracking the whole market, a fund tracking one sector, or a fund tracking one narrow industry or theme. Once this hierarchy is clear, the question “what is an ETF” in the next chapter stops being abstract.

## Four Real Funds, Four Altitudes

These are separate, independent funds — not funds nested literally inside one another. Each simply sits at a different level of the same ladder.

| Level | Example | What It Covers |
|---|---|---|
| Broad Market | VOO | Roughly 500 large U.S. companies |
| Sector | XLK | The technology sector broadly |
| Industry / Thematic | TAN | Solar-focused companies specifically |
| Company | (any individual holding) | One business within the chosen industry |

**IN PLAIN LANGUAGE**

> *The teaching point isn't any single fund. It's that ETFs let you choose how wide or narrow your exposure is — the whole market, one sector, or one narrow theme. VOO returns in Chapter 7, applied through a full evaluation — worth remembering, not just reading once.*

CHAPTER 2

# UNDERSTANDING ETFS: THE CHIP AISLE

Picture the chip aisle at a grocery store. You want chips, but the aisle has chips, popcorn, and pretzels — and within chips alone, there's salted, vegan, kettle-cooked, barbecue. Each bag on the shelf is a different company.

**If you said, "I'll just buy the whole chip aisle," instead of picking one bag, you've essentially just bought an ETF.**

That's what an Exchange-Traded Fund actually is: a single fund that holds many individual companies (or bonds, or other assets) inside it, traded on an exchange just like a single stock. Buying one share gives you a small slice of everything the fund holds — not just one bag off the shelf, the whole aisle.

### IN PLAIN LANGUAGE

> *FS-001 introduced the idea that assets play different roles — financial, hard, protection, speculative, income-producing. An ETF is a financial/paper asset: it can give you exposure to several of those roles at once, depending on what it holds, without needing to reteach that framework here.*

Connecting back to Chapter 1's ladder, an ETF can be built at any altitude:

- "Buy the whole grocery store" — a broad market fund like VOO.
- "Buy the whole chip aisle" — a sector fund like XLK.
- "Buy just the vegan chips" — a narrow industry or thematic fund like TAN.

For a steward specifically, this matters because one purchase now carries built-in diversification. There's no need to correctly guess which single bag of chips — which single company — wins.

CHAPTER 3

# KNOW WHAT'S INSIDE THE BASKET

Every ETF publishes its holdings — the specific companies it owns and in what proportion. Knowing what's actually inside the basket, rather than assuming, is the entire point of this chapter.

## Weighting Isn't Even

Most ETFs aren't equal-weighted. A fund labeled “Technology” might be 20% or more concentrated in just one or two mega-cap companies. Owning the fund means owning that concentration, whether or not the label makes it obvious.

### IN PLAIN LANGUAGE

> *You wouldn't buy “the chip aisle” without noticing it's secretly a quarter one brand. The same discipline applies here — check the actual holdings before buying, not just the fund's name.*

## Where to Actually Look

Every major fund provider publishes current holdings and weighting on the fund's own page — search the ticker plus “holdings” to find it directly from the provider, not a secondhand summary. This is a two-minute check worth doing every time, not just once.

CHAPTER 4

# THE 11 SECTORS

Chapter 1 introduced Sector as the second rung of the Market → Sector → Industry → Company ladder. There are eleven of them. Knowing all eleven, and knowing them correctly, is what actually makes that ladder usable rather than theoretical.

| Sector | What It Covers | A Few Companies In It |
|---|---|---|
| Information Technology | Hardware, software, semiconductors, cloud infrastructure | Apple, Microsoft, Nvidia |
| Financials | Banks, insurance, investment firms, payment processors | JPMorgan Chase, Visa, Berkshire Hathaway |
| Health Care | Pharmaceuticals, biotech, medical devices, health insurers | Eli Lilly, UnitedHealth Group, Johnson & Johnson |
| Consumer Discretionary | Non-essential goods and services; cyclical, tied to consumer confidence | Amazon, Tesla, Home Depot |
| Consumer Staples | Essential goods people buy regardless of the economy; defensive | Walmart, Costco, Procter & Gamble |
| Communication Services | Telecom, media, entertainment, social and search platforms | Alphabet, Meta Platforms, Netflix |
| Industrials | Aerospace, defense, machinery, transportation, construction | Boeing, Caterpillar, Honeywell |
| Materials | Raw materials, chemicals, mining, packaging | Linde, DuPont, Freeport-McMoRan |
| Real Estate | REITs and property-related companies | Prologis, American Tower, Public Storage |
| Energy | Oil, gas, exploration, and energy equipment & services | Exxon Mobil, Chevron, Schlumberger |
| Utilities | Electric, gas, and water utility companies | NextEra Energy, Duke Energy, Southern Company |

## A Classification Actually Matters

Sector placement isn't a minor detail — it changes what a company's presence in an ETF actually tells you. Netflix sits in Communication Services, not Consumer Staples, because it's a media and entertainment platform, not a maker of everyday household goods. Costco, by contrast, genuinely belongs in Consumer Staples — people buy groceries and household essentials there regardless of the economic climate. Confusing the two isn't a small mistake; it means misunderstanding what kind of exposure you actually hold.

### IN PLAIN LANGUAGE

*Before assuming what sector a company belongs to, check. It's a fast lookup, and getting it right is what makes the rest of this chapter's ladder actually work.*

CHAPTER 5

# FROM SECTOR TO COMPANY: FINDING THE POWER 5

This is the practical version of “open the basket” from Chapter 3, walked all the way down to individual companies. The path:

**Pick a sector → find the ETFs that track it → inspect the top 10 holdings → identify the Power 5 → understand those companies.**

## Worked Example: Financials

Start with a sector — Financials. A quick search surfaces ETFs built to track it. Open one and look at its holdings, the same way Chapter 3 taught. A Financials-sector ETF's top 10 holdings might include names like these:

- Berkshire Hathaway
- JPMorgan Chase
- Visa
- Mastercard
- Bank of America
- Wells Fargo
- Morgan Stanley
- American Express
- Goldman Sachs

## The Power 5

Not all 10 holdings carry equal weight. In most sector ETFs, a handful of companies make up a disproportionate share of the fund — call this the Power 5. Identifying which five actually drive the fund's behavior is more useful than trying to hold equal familiarity with all ten. Check the fund's own page for current weighting to see exactly which five that is today, since this shifts over time and isn't something to memorize as fixed.

## Understanding the Companies, Not Just the Names

Once the Power 5 are identified, the actual work begins — this is where FS-004: Dividend Investing picks up in depth, but the starting questions belong here too:

- What does the company actually do, and how does it make money?
- What sector and industry is it in — confirmed, not assumed?

- Does it have a real advantage over its competitors?
- How much cash does it hold, and how much debt?

**IN PLAIN LANGUAGE**

*Owning a sector ETF means owning these companies whether you've ever looked at them individually or not. The Power 5 approach makes that ownership informed instead of passive.*

CHAPTER 6

# KNOW WHAT YOU'RE PAYING

Every ETF charges an expense ratio — an annual fee, taken as a percentage of assets, for holding the fund. It sounds abstract as a percentage. It shouldn't stay abstract.

## The Actual Math

A 0.70% expense ratio costs approximately **$7 per year for every $1,000 invested.** That's the whole calculation — multiply the percentage by however many thousands you hold. A $10,000 position at 0.70% costs about $70 a year. Do this math for any fund before buying it; it takes seconds and removes the guesswork.

## A KLF Preference, Not a Rule

All else being reasonably equal, lower cost is generally better — something under roughly 0.50% is a reasonable cost-conscious guideline. But cost is one input, not a veto. A well-constructed fund at 0.60% can still be the better choice over a poorly-constructed one at 0.15%, depending on what it actually holds and why it exists in the portfolio (Chapter 10 builds this into a full framework).

IN PLAIN LANGUAGE

> *This is the same instinct FS-001's spending discipline teaches, applied here to fund selection instead of a monthly budget. Cost-consciousness is a stewardship habit, not a narrow investing rule.*

CHAPTER 7

# UNDERSTANDING RETURN & INCOME

Three numbers get conflated constantly. They are not the same thing.

| Term | What It Actually Measures |
|---|---|
| Price Return | How much the fund's share price itself has changed. |
| Total Return | Price return plus any distributions reinvested — the more complete picture. |
| Distribution Rate | What the fund is currently paying out — not automatically the same thing as how much money is actually being made. |

## Where to Check, Not What the Number Currently Is

Any ETF's provider page shows 1-year, 3-year, 5-year, and since-inception performance, updated continuously. This module teaches the skill of finding and reading those figures — not a snapshot of what they happen to say today, which would go stale the moment it's printed.

### IN PLAIN LANGUAGE

> *Any performance figure that does appear anywhere in this guide carries a “Data as of [date]” label for exactly this reason — markets move, and a specific number without a date quietly becomes misleading over time.*

This distinction matters more than it might seem right now — Chapter 8 depends directly on knowing the difference between a distribution rate and a total return.

CHAPTER 8

# POSTURE & POSITIONING: GET SOME SKIN IN THE GAME

**Start where you are. You don't have to know everything before you begin, but you should understand what you're buying before you put money into it.**

This chapter is about learning through responsible participation — not market timing, and not a lesson in reading risk-on or risk-off market conditions. That's a different conversation entirely.

Begin with an amount genuinely appropriate for your own situation — small enough that it's a real learning position, not a bet. Once it's real money, actually watch it: check the holdings again now that they're yours, notice how the price moves day to day, get comfortable reading a brokerage statement.

## A Basic Caution, Not a Percentage

Don't overcommit to one sector or theme simply because it's exciting right now. This chapter isn't going to prescribe a specific portfolio percentage — that's a more personal conversation than this module's job — but the instinct to size a position appropriately, rather than emotionally, belongs here at a plain level.

IN PLAIN LANGUAGE

> *This is the same pattern already established elsewhere in the Financial Stewardship Library — FS-001's 14-Day Action Plan, DA-004's guided wallet setup. Understanding deepens through doing, not only through reading.*

CHAPTER 9

# COMPARING SIMILAR ETFS

**Two funds can point at almost the same exposure and still be genuinely different products. The question that matters: which ETF gives me the exposure I actually want, and at what cost?**

## Three Real Pairs

| Pair | Both Track |
|---|---|
| SPY vs. VOO | The S&P 500 — broad U.S. market exposure |
| SMH vs. SOXX | Semiconductor companies |
| XLE vs. OIH | Energy — though not identically: one is broader energy, the other leans toward oil services specifically |

## What to Actually Compare

For any pair pointing at similar territory, work through the same questions side by side:

- **Holdings** — do they actually hold the same companies, in the same proportions?
- **Concentration** — is one fund more top-heavy in its largest few holdings than the other?
- **Expense ratio** — run the Chapter 6 math on both; a small difference compounds over time.
- **Strategy** — is either fund doing something structurally different (e.g., market-cap weighted vs. equal-weighted, or a narrower slice of the same broad category)?
- **Liquidity** — how easily can it be bought and sold without moving the price? Trading volume is the quick check.
- **Performance** — compare total return, not just price return (Chapter 7), over the same timeframe, checked directly on each provider's page with today's date attached.
- **Purpose** — what job is each fund actually doing, and do they do it the same way?

**IN PLAIN LANGUAGE**

> *Two funds tracking “the same thing” in their name can behave differently in practice. The comparison itself — not either ticker specifically — is the skill this chapter teaches.*

CHAPTER 10

# THE KLF ETF EVALUATION FRAMEWORK

Five questions, worked through every time a fund is under consideration. This is the payoff chapter — everything from Chapters 1 through 9 becomes one repeatable tool here.

- 1. Holdings — What does it actually own, and how concentrated is it? (Chapter 3)
- 2. Expense Ratio — What does it cost, in real dollars? (Chapter 6)
- 3. Returns — Price return vs. total return, over what timeframe, as of what date? (Chapter 7)
- 4. Distributions — What is it paying, and is that coming from investment profit or something else? (Chapter 11)
- 5. Purpose — Why does this fund exist in my portfolio? What job is it doing that another fund isn't?

## Applying the Framework to VOO

Returning to Chapter 1's broad-market example, not as a new ticker but as a thread carried through:

- **Holdings** — roughly 500 large U.S. companies, weighted by market size, so the largest handful of companies make up a meaningful share of the fund.
- **Expense Ratio** — broad-market index funds like this are typically among the lowest-cost options available; check the current figure directly on the provider's page and run the actual-dollar math from Chapter 6.
- **Returns** — check 1/3/5-year and since-inception total return directly on the provider's page, with today's date attached.
- **Distributions** — pays a modest dividend passed through from the underlying companies; nothing exotic, nothing requiring the scrutiny Chapter 8 introduces.
- **Purpose** — broad, low-cost core exposure to the U.S. market as a whole — often the foundation a portfolio is built around, with other funds added deliberately around it.

## The Decision, Documented

## The fund I'm evaluating:

______________________________________

## What the five questions revealed:

______________________________________

CHAPTER 11

# ADVANCED: SPECIALIZED INCOME ETFS

How can an ETF use options to generate cash distributions? A different mechanism from anything covered so far — worth understanding, not worth starting with.

## The General Mechanism

An options-income ETF sells options contracts against its holdings and distributes the premium collected as cash to shareholders. That premium income is a different thing entirely from the underlying stock simply going up — it's generated whether the stock rises, falls, or goes nowhere.

## Worked Example: NVDY

NVDY is built around NVIDIA. The mechanism, step by step:

- **Underlying stock** — NVIDIA (NVDA) is the reference security the fund is built around.
- **Synthetic exposure** — rather than simply holding NVDA shares outright, the fund typically uses options to create exposure that tracks NVDA's price movement.
- **Call-writing** — the fund sells (writes) call options against that exposure, collecting payment upfront for doing so.
- **Option premium** — that upfront payment is the premium — income generated regardless of what NVDA's price does next.
- **Distribution** — the collected premium is distributed to shareholders as cash, often on a monthly schedule.
- **Capped upside / trade-offs** — writing calls generally caps how much upside the fund can capture if NVDA rises sharply, in exchange for the steady premium income. Income is generated; some upside potential is given up to generate it.

## The Same Structure, Two More Examples

TSLY (built around Tesla) and GOOY (built around Alphabet) use the same underlying mechanism — different reference stock, same call-writing structure, same trade-off between income and capped upside. Seeing the same pattern across three different underlying companies is the actual lesson: this is a repeatable ETF structure, not a one-off product.

## A LARGE DISTRIBUTION IS NOT AUTOMATICALLY INVESTMENT PROFIT

Seeing a 40%, 60%, or higher distribution rate can reasonably look like “this fund is earning me that percentage.” That conclusion can be wrong. Some of what's distributed comes from option premium rather than genuine appreciation, and the fund's share price can decline over time even while distributions continue steadily. The distribution rate alone can mislead without also checking total return — the exact distinction Chapter 7 introduced. Always look at both numbers together, never the distribution rate alone.

This chapter teaches the income mechanism — how an ETF generates distributions through options. It does not teach how to evaluate a dividend-paying company's underlying fundamentals. That is FS-004: Dividend Investing's job, not this one — a different question entirely.

CHAPTER 12

# ADVANCED: LEVERAGED & INVERSE ETFS

How can an ETF magnify or reverse daily market exposure? A genuinely different mechanism and risk profile from Chapter 8 — kept separate deliberately, not a lesser version of the same idea.

## Definitions

- **Leveraged ETF** — aims for a multiple, such as 2x or 3x, of a benchmark's daily move.
- **Inverse ETF** — aims for the opposite of a benchmark's daily move.
- **Leveraged-Inverse ETF** — combines both: a magnified, opposite daily move.

## The Word “Daily” Matters More Than It Looks

These funds reset their target exposure every single day. That single fact means their return over any period longer than a day can diverge significantly from simply multiplying the underlying benchmark's return over that same period — a real mechanism (sometimes called volatility decay or compounding drift), not just a vague warning label.

IN PLAIN LANGUAGE

> *A benchmark that goes up 10% then down 10% ends up roughly flat over two days. A 2x leveraged fund tracking it daily does not necessarily end up at roughly flat — the daily resets compound in a way that can leave it lower, even though the underlying benchmark returned to close to where it started.*

## Built for a Different Purpose

These are generally built for short-term, tactical use — held for days, not years. Holding one for the long term exposes an investor to the daily-reset mechanism working against them in ways a simple “2x the index” assumption doesn't capture. Different mechanism, different risk, different intended holding period than anything in Chapter 8.

KLF PRINCIPLES

# KNOW WHAT YOU OWN

- Understanding what's inside the basket — holdings, cost, and structure — is itself a form of stewardship, not a technicality reserved for experts.
- Cost-consciousness is a KLF instinct, not a rigid rule. Lower is generally preferred; purpose still matters more than cost alone.
- Starting small and learning through real participation beats waiting for perfect knowledge before beginning.
- Advanced structures — options-income and leveraged funds — exist and can be understood, but they are not where this journey starts. The Evaluation Framework in Chapter 7 is.
- A large distribution is not automatically investment profit. Always check total return alongside it.

APPENDIX

# GLOSSARY

| Term | Definition |
|---|---|
| Sector | A broad category of business within the market (e.g., Technology, Energy, Healthcare). |
| Industry | A narrower grouping within a sector (e.g., semiconductors within Technology). |
| Expense Ratio | The annual fee charged for holding a fund, expressed as a percentage of assets. |
| Total Return | Price return plus reinvested distributions — the complete performance picture. |
| Distribution Rate | What a fund is currently paying out; not automatically equivalent to investment profit. |
| Options-Income ETF | A fund that sells options against its holdings and distributes the collected premium as income. |
| Leveraged ETF | A fund aiming for a multiple of a benchmark's daily move, reset daily. |
| Inverse ETF | A fund aiming for the opposite of a benchmark's daily move, reset daily. |
| Volatility Decay | The compounding effect of daily resets that can cause a leveraged or inverse fund's longer-term return to diverge from a simple multiple of the benchmark's return. |

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