ETFs & Index Funds

BEGINNER LESSON EXPLAINER

What Is an ETF, Really?

An ETF (Exchange-Traded Fund) is a single security that holds a whole basket of other investments — often hundreds of individual stocks — inside it. When you buy one share of an ETF, you're not betting on one company; you're buying a small, proportional slice of every company the fund holds, all in a single trade that clears just like buying an ordinary stock.

A useful analogy: think of an ETF like a fruit basket instead of a single apple. Buy the basket and you get a bit of everything inside it — apples, oranges, bananas — in one purchase, instead of visiting five different stalls to build the same variety yourself.

Real Example: One Trade vs. Ten Trades

VOO, Vanguard's S&P 500 ETF, holds around 500 U.S. companies inside a single fund. One share currently costs about $690. Just to buy 1 share each of VOO's 10 largest individual holdings — Nvidia, Apple, Microsoft, Amazon, and the rest — costs $4,183, and you'd still only own 10 of the fund's roughly 500 companies.

	1 share of VOO	Top 10 holdings, individually
Cost	$690	$4,183
Companies owned	~500	10
Trades needed	1	10

Six times the cost, ten separate trades to manage, and you'd still be missing the other ~490 companies inside VOO entirely. One ETF share isn't just simpler — it's structurally a completely different scale of diversification.

Real Example: Why One Company Can't Sink the Fund

Here are VOO's actual top 10 holdings and their real weight inside the fund. Notice how small even the single largest position is.

Company	Weight in VOO
Nvidia (largest holding)	7.5%
Apple	6.6%
Microsoft	4.3%
Amazon	3.6%
Alphabet (both share classes)	5.8%
Broadcom	2.8%
Micron	2.0%
Meta	1.9%
Tesla	1.8%
All other ~490 companies	63.7%

Nvidia — the single largest company in the entire fund — is still only 7.5% of it. If Nvidia's stock fell to $0 overnight, VOO would fall by roughly 7.5%, not 100%, because the other ~499 companies would be completely unaffected. Compare that to owning 100% Nvidia stock directly, where the same event wipes out your entire position.

5 Things to Know About ETFs

1. An ETF trades all day on an exchange, just like a stock — unlike old-style mutual funds, which only price once a day after the market closes.

2. Broad index ETFs charge a tiny annual fee — VOO's expense ratio is just 0.03%, about $3 a year on a $10,000 investment.

3. You don't get to pick which companies are inside — the fund's rules (its “index”) decide that for you.

4. Not all ETFs are broadly diversified — some track a single sector, country, or theme, and can be just as concentrated as owning individual stocks.

5. ETFs can pay dividends too, passed through from the dividends of the companies held inside them.

4 Things to Check Before You Buy an ETF

Check What Index It Actually Tracks. “S&P 500”, “Nasdaq 100”, and a niche thematic index can behave very differently. Read the fund's one-line description before assuming what's inside it.

Compare the Expense Ratio. Even among broad index ETFs, fees can vary meaningfully. A fraction of a percent compounds over decades. 0.03%–0.10% is typical for a broad, low-cost index ETF.

Check How Many Holdings It Actually Has. “Diversified” ETFs can range from 30 holdings to 3,000+. More holdings generally means risk is spread more thinly.

Look at Trading Volume. A popular, heavily-traded ETF is easier to buy and sell at a fair price. Thinly-traded, niche ETFs can have wider bid-ask spreads — a real, if quiet, extra cost.

Worth knowing: VOO is used here purely because it's one of the largest, most recognizable ETFs with public numbers — not a recommendation to buy it specifically. Not every ETF is broadly diversified like a total-market or S&P 500 fund; some concentrate in a single sector or theme and can carry risk much closer to an individual stock.

Quick Check: 5 Questions

Answer all five before turning the page to check yourself against the answer key.

1. What do you actually get when you buy one share of a broad-market ETF like VOO?

- A. A loan to the fund company
- B. A single company's stock
- C. A proportional slice of every company the fund holds, all in one trade
- D. A guaranteed fixed return

2. In the VOO example, why did buying 1 share each of the top 10 holdings cost $4,183, while 1 share of the whole fund cost only $690?

- A. The combined price of 10 individual company shares can easily exceed the price of one diversified ETF share
- B. VOO's fee eats away the difference
- C. The top 10 companies are actually excluded from VOO
- D. ETF prices are fixed by regulation

3. If VOO's single largest holding fell to $0 overnight, roughly what would happen to the fund overall?

- A. The whole fund would also fall to $0
- B. The fund would be completely unaffected
- C. The fund would automatically double its position in every other company
- D. The fund would fall by roughly that holding's weight in the fund, not all the way to zero

4. What's true about an ETF's expense ratio?

- A. It's usually the single biggest cost for a broad index ETF investor over decades
- B. It's a small annual fee, and for a low-cost broad index ETF it can be as little as a few basis points (e.g. 0.03%)
- C. It doesn't exist for ETFs, only mutual funds
- D. It's charged only once, when you first buy

5. Which of these statements about ETFs is true?

- A. Every ETF is automatically broadly diversified across hundreds of companies
- B. ETFs can only be bought once a day, after the market closes
- C. Some ETFs track a single sector or theme and can be just as concentrated as an individual stock
- D. ETFs never pay dividends

Quiz Answer Key

1 C — An ETF share gives you proportional ownership in every company inside the fund at once — not a loan, and not exposure to just one company.

2 A — Each of the 10 individual shares has its own market price — added together they came to $4,183, versus $690 for one share representing all ~500 companies at once.

3 D — Since that holding is only around 7.5% of the fund, its total collapse would drag the whole fund down by about 7.5% — not to zero — because the other ~499 companies are unaffected.

4 B — VOO's expense ratio is just 0.03% a year — about $3 annually on a $10,000 investment. It's an ongoing fee, not a one-time charge, but for a low-cost broad index ETF it's typically small.

5 C — Not every ETF is broad and diversified — sector or thematic ETFs can hold a small number of companies and carry risk much closer to owning an individual stock.