ROUND TABLE
WEALTH MANAGEMENT

Mutual Funds vs. ETFs

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If you are new to the investing world, you might find the prospect of choosing individual stocks and bonds to be incredibly time consuming and complex. You may have personal connections to certain brands, but how can you decide whether purchasing Amazon, McDonalds, or Nike stock is the right investment for your portfolio? Fortunately, this challenge is faced by millions of investors who do not have the time, the experience, or the desire to select and manage their own portfolio of individual investments. Buying investment vehicles such as mutual funds and Exchange Traded Funds ("ETFs") offers an effective solution.

ETFs and mutual funds are professionally managed investment vehicles that consist of a diversified basket of individual investments, providing exposure to segments of the stock market or the stock market as a whole. They invest in stocks, bonds, and other assets and are priced relative to the value of those underlying investments. They can be purchased in a traditional brokerage account like at TD Ameritrade or through a 401(k) account in your work-sponsored retirement plan. Below are a few important similarities and differences to keep in mind when deciding whether to purchase a mutual fund or an ETF.

Similarities

There are several similarities between mutual funds and ETFs. Both mutual funds and ETFs invest in a diversified basket of stocks and/or bonds. There is no minimum or limit as to how many underlying investments a mutual fund or ETF may hold, and this can range from as little as 20 holdings to as many as a few thousand. Due to the diversification benefits of owning a basket of stocks, mutual funds and ETFs are typically considered less risky than investing in an individual stock. They also offer a wide range of investment options, allowing you to create an investment focus as specific or as broad as you desire. You can invest in a specific asset class, like Real Estate, a specific country, like Japan, or even an entire region, like Europe, through both ETFs and mutual funds.

Differences

There are, however, some important differences to note when considering investing in a mutual fund versus an ETF.

Active vs. Passive Management

The major difference between the two is that mutual funds are typically actively managed while ETFs are typically passively managed (i.e., index funds). A fund that is actively managed means that there is a team of investment professionals who are buying and selling stocks within the fund in an attempt to beat a given benchmark (or the market). For example, they may decide that they want to hold Amazon stock and would rather own Under Armour than Nike stock. Passively managed strategies (more typical of ETFs) are invested by a rules-based methodology that typically seeks to track a market index or other predetermined investment universe. This means that if the market index has Amazon and Nike, the passively managed ETF will have both of these companies as well. Because of the increased research, technology, and human capital that goes into selecting stocks, actively managed mutual funds tend to have higher fees than ETFs. For this reason, there has been a global trend by more fee-sensitive investors towards using ETFs in their portfolios.

Trading

Another key difference between mutual funds and ETFs is how and when they are traded. The shares of an ETF can be traded intra-day (i.e., during market trading hours which are 9:30am-4:00pm) and thus have "real time" pricing. On the other hand, mutual funds only trade once a day after the market closes, and thus only report an end-of-day Net Asset Value (NAV) of the fund. This difference allows you to trade an ETF at any point during the normal trading hours of a day at its listed price, whereas a mutual fund investment will occur at 4:00pm (market close) regardless if the trade was placed at 9:30am or at 3:30pm. This added flexibility can allow you to hear positive or negative news on TV and immediately decide to buy or sell an ETF.

Fortunately, you do not have to pick one OR the other! Many investors have a mix of low-cost ETFs and actively managed mutual funds in their portfolios and some have both in addition to individual stocks as well. As with many topics in the investment world, there is no "right" or "wrong" and your individual circumstances or preferences may dictate the use of one or both investment vehicles in your portfolio. To see if your portfolio is allocated appropriately for your situation, reach out to a Round Table Wealth Advisor.

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