ETF or mutual fund? Which is right for you?

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ETFs (exchange-traded funds) are often compared and contrasted with mutual funds. As ETFs continue to gain popularity among their mutual fund counterparts, it is important for investors to know the nuances of each investment vehicle.

In this article, we highlight key considerations that may be important to investors evaluating which vehicle to choose, such as implications for tax efficiency, the differences in how mutual funds and ETFs are bought and sold, and the types of costs encountered when investing in the two vehicles.

How are ETFs and mutual funds alike?

Both ETFs and mutual funds have a similar structure.

The two investment vehicles are made up of individual securities, like stocks and bonds, to form a “basket” or “pool” of investments.

ETFs and mutual funds both offer exposure to a wide variety of asset classes and niche markets. A diversified portfolio can be created by using one of the two options. Since the vehicles are made up of multiple investments, they generally provide more diversification than a single stock or bond.

How are ETFs and mutual funds different?

	ETFs	Mutual Funds
How are they managed?	While they can be actively or passively managed by fund managers, most ETFs are passive investments pegged to the performance of a particular index.	Mutual funds come in both active and indexed varieties, but most are actively managed. Active mutual funds are managed by fund managers.
How are they traded?	ETFs trade like stocks and are bought and sold on a stock exchange, experiencing price changes throughout the day. This means that the price at which you buy an ETF will likely differ from the prices paid by other investors.	Mutual fund orders are executed once per day, with all investors on the same day receiving the same price.
What's the minimum investment?	Because they trade like stocks, ETFs do not require a minimum initial investment and are purchased as whole shares. You can buy an ETF for the price of just one share, usually referred to as the ETF's "market price."	Minimum initial investments for mutual funds are normally a flat dollar amount and aren't based on the fund's share price. Unlike ETFs, mutual funds can be purchased in fractional shares or fixed dollar amounts.
What are the costs?	ETFs have implicit and explicit costs. While your broker will disclose the cost of trading commissions and the ETF provider will disclose the operating expense ratio, don't overlook the bid/ask spread and premium/discount to NAV. These costs are implicit and result from buying or selling an ETF in the market at a price which may differ from the value of the ETF's underlying holding.	Mutual funds can be purchased without trading commissions, but in addition to operating expenses they may carry other fees (for example, sales loads or early redemption fees.
What about tax efficiency?	ETFs often generate fewer capital gains for investors since they may have lower turnover and can use the in-kind creation/redemption process to manage the cost basis of their holdings.	A sale of securities within a mutual fund may trigger capital gains for shareholders—even for those who may have an unrealized loss on the overall mutual fund investment.

ETF or mutual fund? Which is right for you?

That all depends on your goals and the type of investor you are. The decision to invest in a mutual fund versus an ETF depends in part on an investor's preference for one vehicle type over the other.

An investor may want to consider an ETF if they are an active trader. This includes intraday trades, stop orders, limit orders, options, and short selling. An ETF provides trading flexibility to accommodate all of these trades, whereas, a mutual fund cannot.

An ETF may be used for tax sensitive situations. In general, ETFs tend to be more tax efficient than index mutual funds.

An investor may want to consider a mutual fund if they invest frequently. Examples of this include dollar-cost-averaging or making regular deposits into an account. Mutual funds give the ability to purchase fractional shares to the investor. This means an investor can purchase the same dollar amount each time they invest, therefore, letting no dollar go to waste.

A mutual fund may be used when a similar ETF is thinly traded. When you buy or sell ETF shares, the price may be less than the net asset value (NAV) of the ETF. The difference ("bid/ask spread") is often insignificant, but for less actively traded ETFs, that might not always be the case. The investor must cover the “bid/ask spread” incurring an additional cost. By contrast, mutual funds always trade at NAV, without any “bid/ask spreads”, avoiding that cost.

In sum, in either an ETF or mutual fund, Dopkins Wealth Management invests with an investment philosophy based on academic evidence. Offering both vehicle structures allows investors to choose the vehicle most suitable for their unique circumstances. As always, there exists a risk of loss with any investment. You should consult with your investment advisor before making any decisions. Dopkins Wealth Management can help you achieve your investment goals.

For more information, contact Ryan Smith at rsmith@dopkins.com.

** Dopkins Wealth Management, LLC is a registered investment advisor owned by the partners of Dopkins & Company, LLP.*

1 Source: Investing with Dimensional in a Mutual Fund versus Exchange-Traded Fund
https://my.dimensional.com/investing-with-dimensional-in-a-mutual-fund-versus-exchange-traded-fund

2 Source: ETFs vs. Mutual Funds – What’s the Difference? | Charles Schwab
https://www.schwab.com/etfs/mutual-funds-vs-etfs