MODULE

A Deeper Dive Into ETFs & Mutual Funds

POWERED BY

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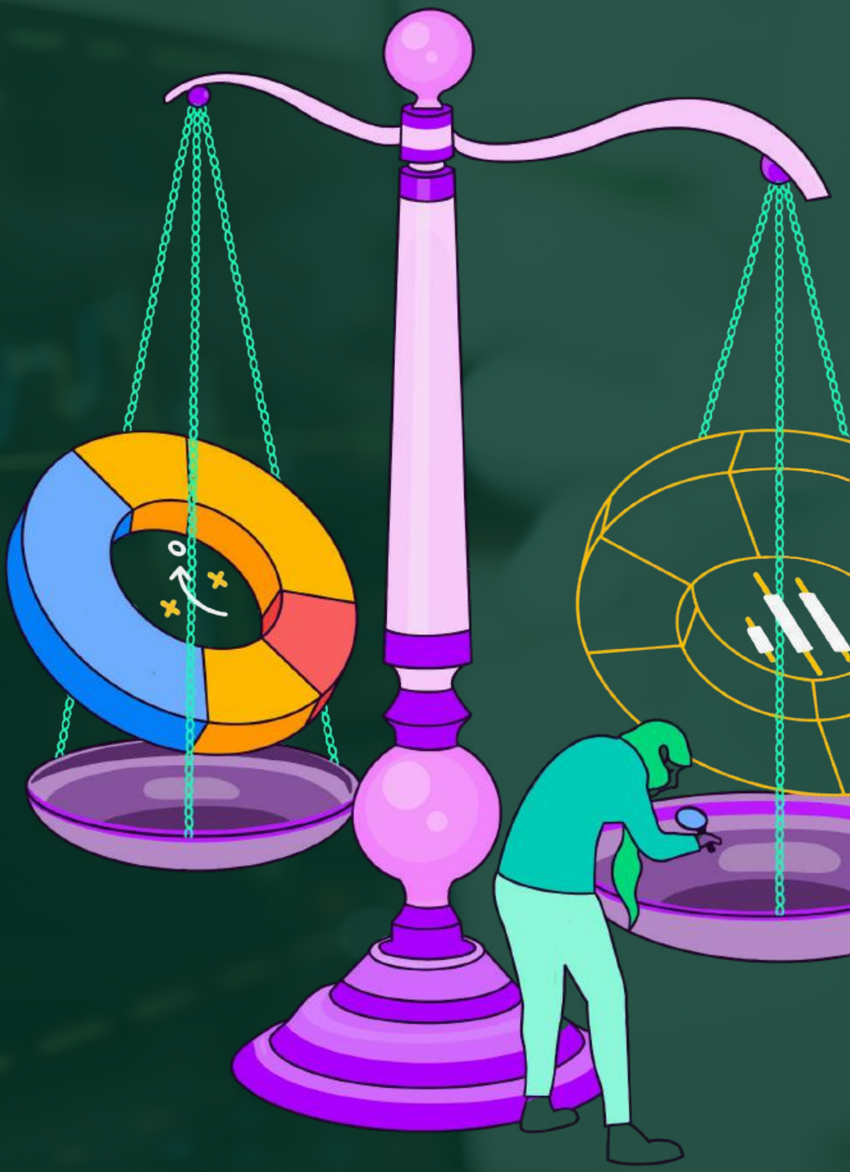

Key Takeaways From This Module

Guiding Questions

- What are ETFs and Mutual Funds?
- How can ETFs and Mutual Funds help build a more diversified portfolio with exposure to hundreds of companies?
- Are there any special tax treatments for ETFs or Mutual Fund which we should appreciate before investing?
- Are ETFs or Mutual Funds a better investment?

Enduring Understandings

- ETFs & Mutual Funds provide a way for investors to invest in a basket of stocks or other assets at a much lower cost than purchasing all of the assets independently.
- ETFs provide investors with the opportunity to own shares in an asset whose performance is designed to mirror a stock index or industry.
- Mutual funds are more actively managed than ETFs, so they may cause investors to incur a greater tax liability.
- Mutual funds make distributions to investors which may provide an additional source of income for some investors.

So What Are Mutual Funds?

Unlike an ETF, which is listed by a company as a security for investors to trade, a mutual fund operates as both an investment and an actual company.

A mutual fund starts by raising large amounts of capital from public investors to purchase hundreds of different securities, usually stocks and bonds, which means mutual fund shareholders (similar to investors in ETFs) **gain diversification at a low price**. Similar to an ETF, the value of a mutual fund depends upon the performance of the underlying securities the mutual fund purchases.

The value of the mutual fund company depends on the performance of the securities it decides to buy, however, an investor's performance in a mutual fund is not the same as owning the underlying stock.

Mutual fund shares do not give its holders any voting rights.

Additionally, mutual funds do not aim to mirror the performance of underlying securities in the long-run. That's because mutual funds make distributions!

Mutual Fund Distributions

A collection of the funds' profits derived from dividends and the result of selling investments at a higher price for a gain. Typically mutual funds will distribute this excess capital each quarter, providing a source of income to mutual fund shareholders.

A Venn Diagram of ETFs & Mutual Funds

Exchange Traded Funds

- A vehicle for investors to earn from the performance of multiple securities in an underlying ETF while only owning shares in a single fund.
- Typically passively managed.
- Have lower fees, more tax efficient, and offer more liquidity

Both

Help investors build a diversified portfolio which would be challenging & expensive for investors to create on their own.

Mutual Funds

- A pool of like-minded investors who collectively decide to have their money invested and managed by a professional.
- Typically actively managed, with managers regularly buying and selling securities to beat the market
- Have higher fees and expense ratios

Tax Implications for ETFs & Mutual Funds

Unfortunately, investing is so accessible these days that no one explains the tax implications of investing until it's too late.

ETFs are structured so that they don't pass capital gains onto the investors in the ETF and incur fewer tax liabilities. An ETF can be thought of a basket of assets, and while there may occasionally be rebalancing for an ETF, most ETFs are very passive.

However, in a mutual fund, the manager must constantly buy and sell securities to keep the fund balanced due to people withdrawing money from the fund or the change in pricing of the securities they have in their portfolio. Typically, the sales of these securities accumulates a capital gain for the shareholders of the fund, even if the shareholder has an unrealized loss over the time they have been invested in the mutual fund since tax implications are applied each year.

To mitigate this, many mutual funds tend to be passive and do not rebalance their portfolio frequently. This means the fund is creating less transactions so are realizing less of their gains in the current year.

The end goal for many mutual fund managers (in addition to making money) is to reduce the amount of taxes the shareholder has to pay.

What To Look For In ETFs & Mutual Funds

Substantial Assets
If an ETF or Mutual Fund has less than $10 million in assets, there will be limited interest from investors, resulting in wide spreads & lower liquidity.

High Liquidity
Higher trading volume for an ETF or mutual fund indicates higher liquidity, which means you can sell shares more easily than in an illiquid security, which may force you to sell at a discount.

Low Expense Ratio
ETFs have lower expense ratios because they are are passively managed, however, even for an actively managed mutual fund, investors should aim for expense ratios that are less than 1%.

Tight Spread
Investors should seek out ETFs and Mutual Funds which have narrow Bid/Ask prices because this indicates that there is a high level of investor interest & trading activity.

Value Tracking
ETFs & Mutual Funds track the value of the assets the fund owns, however, if the fund does not track the underlying assets closely, tracking errors may impact your performance.

Finding ETFs On The Rapunzl App

Alright so you want to get started by purchasing an ETF on the Rapunzl App?

That's a great decision because with one trade, you can gain exposure to hundreds of companies and build a well-diversified portfolio.

We've taken away a little bit of the struggle researching ETFs by organizing some of the largest and most popular ETFs on the Rapunzl Home Screen.

Just scroll down to the Industry Performance Section and tap the header, which will take you to a list with the 10 major industries.

If you select an industry, you can learn more about how the industry performs during different market cycles, understand why some industries have higher risk-reward profiles, and discover ETFs which track companies specific to that industry!

This is a great opportunity to get started. Once you have a portfolio which is exposed to a lot of companies and diversified across industries, you can start using parts of your capital towards specific stocks.