Comparing Mutual Funds and Exchange Traded Funds

Welcome
The Webinar Will Begin at 12:00 EDT

Comparing Mutual Funds and Exchange Traded Funds

Next Month's Webinar
Introduction to IRAs
August 14, 12:00 to 1:00 p.m.

Cooperative Extension

• Nationwide educational network.
• Each state and territory
  — Land-grant university and a network of local and regional offices.
• Reaching out
  — Extends the education and research from the university into the local community
  — Solve public needs with university resources through non-formal programs

Cooperative Extension in Florida

• Partnership between University of Florida & County Governments
  — All 67 counties in Florida have Extension offices
  — Most have a Family & Consumer Sciences Agent
  — Main website www.SolutionsForYourLife.com

Webinar Team

For More Information, Contact:
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An Equal Opportunity Institution
Comparing Mutual Funds and Exchange Traded Funds

Please complete the SHORT evaluation that will be sent following the webinar.

This webinar is approved for 1 CE for AFCPE for AFC

Sources:
- A Comparison of Mutual Funds and Exchange Traded Funds: Twelve Factors to Consider
- Securities and Exchange Commission
- IRS

Enroll As a Saver
- Receive non-commercial financial management information
- Enroll as a Florida Saves or a Tampa Bay Saver

Considerations
- What are your long-term financial goals?
  - We consider investing a long-term proposition
- How much can you realistically set-aside for those goals?
- What is your target date for each goal?

Why would I want to invest?
- Build financial stability
  - Money earns money
  - Asset appreciation
  - Beat inflation

Why Would I Want to Invest?
- Tax effective
  - Rates paid on long-term capital gains and qualified dividends
    - Taxed at a lower rate than ordinary income
  - Interest earned in savings account taxed at ordinary income rate

Long term capital gain if the asset is held more than 1 year

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Do You Know Your...

- Gross Income
- Adjusted Gross Income
- Taxable Income
- Tax Bracket

Tax Advantaged Plans

- Retirement plans
- College Plans
- Earnings grow tax free — A big advantage!

Investment Options & Considerations

- Many types of investment options
- Pick the most cost effective to reach goals
- Manage risk
- Tax efficiency
- Costs for different options

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Considerations
- Risk and Return
  - Risk Tolerance
- Diversification
  - Accumulate different assets to reduce risk
- Asset Allocation
  - The percentage of your money or portfolio to be invested in each type of asset

Securities
- Stocks
- Bonds
- Purchasing
  - Transactions costs for buying & selling
  - There may also be a commission cost

Stock
- A share of ownership in a company
- Also called equity shares
- Value of shares can fluctuate
- Some companies pay dividends to shareholders

Bonds
- A loan to a corporation, the federal government, or a municipality
- You are paid interest for the loan
  - Some bonds are tax-free
- Capital appreciation
  - Bonds can be sold on the secondary market
  - If they increase in value and you sell, then it is a capital gain

Cash Equivalents
- Asset that can be easily converted to cash with little or no loss of value
  - Savings Accounts
  - Certificates of Deposit (CDs)

Diversification & Asset Allocation
Which is an example of a diversified portfolio?

Portfolio 1
- Company A 50%
- Company B 50%

Portfolio 2
- Cash 10%
- Company A 40%
- Company B 50%
- Real Estate 10%

These are educational examples, they are not recommendations

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**Mutual Funds**

- An investment company pools the assets of many investors to purchase securities
- Investors buy shares in the fund
- Funds can be invested in stocks, bonds, money market instruments, real estate, precious metals
- Provides diversification to reduce risk

**Mutual Funds**

- As discussed last time
- Purchase shares in the fund from the investment company or fund supermarket
- Can sell shares back to the company
- Costs to invest
  - Fees
  - Some also have sales commissions or “loads”
  - No loads do not have commissions

**Exchange Traded Funds (ETFs)**

- Relatively new type of investment vehicle
  - First there were index mutual funds
  - Their success led to ETFs in the early 1990’s
  - Some are now actively managed
- Shares are traded on an exchange
  - Similar to the way stocks are traded on an exchange

**Mutual Fund & ETF Similarities**

- Contain a pool of assets
  - Stock, bonds, real estate, & other assets
- Can be specific to a specific sector of the economy
  - Energy, Finance, Technology & others
- Either can be an Index fund
  - Seeks to match the performance of a particular market
    - Examples: Standard & Poor’s 500, Russell 2000 Index, Emerging Market index, & many others
    - Invests in the securities that are included in the index

**ETFs**

- Most ETFs are Index-Based
- One example:
  - SPDR 500 invests to match the performance of the S&P 500
    - index of 500 stocks
- There are some ETFs that are not index funds and are actively managed

**Market Indices**

- Track the performance of a particular “basket” of stocks considered to represent a particular market or sector of the U.S. stock market or the economy
- Examples:
  - S&P 500 is made up of large companies
  - Russell 2000 of small companies
  - Wilshire 5000 is a total market index

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Index Funds

- Tracks a particular group of stocks
- Same returns as the index it tracks minus fees
  - Expenses generally low
- Generally tax efficient
- Some funds sound similar but have slightly different investment goals (always read the prospectus before making decisions)

Mutual Funds & Exchange Traded Funds

- Some differences
  - Traded differently
  - Expense ratios
  - Commissions
  - Taxes

Net Asset Value

- A share in a fund is purchased at NAV (plus sales charges & fees)
- Per share Net Asset Value =
  \[ \text{Total Assets} - \text{Total Liabilities} \]
  \[ \text{Number of Shares Outstanding} \]

Mutual Funds Market Price

- Market price is NAV
- NAV is calculated at the end of day
- Does not fluctuate through the day
- However, may fluctuate from beginning to end of day

ETFs Market Price

- The market price of an ETF will be set by the market
  - Investor demand and supply
- Market Price > NAV
  - Selling at a premium
- Market Price < NAV
  - Selling at a discount

ETFs Cost to Buy & Sell

- Bid and Ask
  - Securities dealer buy at the bid price
  - Sell at the ask price
- Spread is the difference between bid and ask
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**Spread**
- Example
  - Dealer buys a stock for $20
  - Will sell for $21
  - Bid - $20
  - Ask - $21
  - Spread is $1
- Spread is a cost of investing with ETFs

**Trading Expenses**
- ETFs are traded on exchanges so trading costs include commissions
  - Buy share pay a commission
  - Sell shares pay a commission
- No-load mutual funds
  - No commissions
- Which one may have the advantage when using dollar cost averaging?

**Expense Ratios**
- Expense ratio - how much of the funds assets are going towards annual expenses
- Mutual funds tend to have higher operating costs
- ETFs have lower expense ratios
- Which one may have the advantage when holding for a long term?

**Tax Efficiency**
- ETFs are *usually more tax efficient
- Mutual funds usually distribute more capital gains to investors
- When selling, usually easier for the ETF investor to track and identify shares with higher cost basis and lower tax burden
- Individual stock ownership can also be tax efficient, but need more capital to achieve diversification
  *Exceptions leveraged and commodity ETFs

**Reinvesting Dividends**
- Dividend reinvestment from mutual funds is easy and cost effective with mutual funds
- Automatic reinvestment of dividends may be not be possible with ETFs

**Mutual Funds and ETFs**
- Both can provide diversification
- No Load Index Mutual Funds
  - No commissions
  - Low expense ratios
- ETFs
  - Many track an index
  - Low expense ratios
  - Can be more tax efficient than mutual funds

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Additional Factors to Consider

- A Comparison of Mutual Funds and Exchange Traded Funds: Twelve Factors to Consider
- Consider your goals
  - How long do you plan to hold the fund?
- What is your tax bracket?
- How often will you be buying shares?

Demonstrate Fund Analyzer

- FINRA – Set criteria to Exchange Traded
- Is there another one?

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- Introduction to IRAs
  August 14, 12:00 to 1:00 p.m.
- We will discuss differences between Traditional and Roth IRAs and how they may help you achieve long term financial goals.

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