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Mutual Funds and Exchange Traded Funds (ETFs)

What's the Difference?

Mutual funds are one of the most common investment vehicles for Canadians. There are many reasons for their popularity, including their ability to easily provide investors with a diversified portfolio strategy. Exchange Traded Funds (ETFs) are a similar type of investment vehicle. They offer the ability to invest in various market segments and generally cost less than a traditional mutual funds. However, not every investor has access to individual ETFs or the ability to assemble them into an effective well-diversified investment portfolio. That's why mutual funds that invest using ETFs have grown in popularity.

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For many investors, purchasing a mutual fund is a matter of convenience. You can meet your investment needs with an effectively diversified fund that suits your investment objective and risk tolerance. The evolution of Exchange Traded Funds (ETFs) has provided additional choice for investors and enabled new ways for portfolios to be constructed.

Let's look at the similarities and differences of these two investment vehicles and how they can complement each other.

IPC Essentials utilize a traditional mutual fund structure and, rather than investing in individual stocks or bonds, invest in ETFs to achieve their objectives. As mutual funds that invest in ETFs, IPC Essentials provide added value through dynamic asset allocation and currency management while costing less than more traditional funds. For IPC Essentials, our Portfolio Management Team make currency hedge calls by buying either the hedged or unhedged versions of ETFs.

Mutual funds and ETFs have their individual strengths. Both are solid investment choices for investors. As the lines between mutual funds and ETFs continue to blur, we will ensure that we use the best investment vehicles to help investment meet their goals.

COMPARATIVE FACTS

MUTUAL FUNDS		EXCHANGE TRADED FUNDS
A pooled investment vehicle with diversified exposure to different areas of the market. It can invest individual stocks, bonds, commodities, currencies, options or a blend of assets to replicate an index or exchange traded funds, to achieve a specific investment objective. Investors buy or sell units in a fund which represent a proportional interest in the pooled assets.	**WHAT**	A pooled investment vehicle that invests in a particular segment of the market such as stocks, bonds, commodities, currencies, options or a blend of assets, most often to replicate an index, although not always. Investors can buy or sell shares, which represent a proportional interest in the ETF. ETFs trade on an exchange.
Bought and sold daily, but only at the end of the day.	**HOW**	Bought or sold throughout the day.
Can be purchased through mutual fund dealers, including banks and discount brokers, that have licensed financial planners.	**WHERE**	Must be purchased at a full-service brokerage or through a discount brokerage that is licensed to sell individual securities.
Daily price is calculated precisely, based on the net asset value of the sum of all its holdings divided by the number of units (this is typically called the "NAV"). You pay the NAV when you buy a unit of a mutual fund – there is no premium, discount or spread.	**PURCHASE PRICE**	ETFs typically publish a daily NAV, but they must be purchased through a stock market and, as a result, may trade at a premium or discount to their NAV. This means you may pay more, or less, for the basket of stocks than its actual worth. Investors may pay the "spread" when buying or selling ETFs. The spread is the difference between the price you pay to acquire a security and the price at which you can sell it.

MUTUAL FUNDS		EXCHANGE TRADED FUNDS
A portfolio can be in a single asset class, geography or economic sector, or be diversified across multiple asset classes, geographic regions and/or economic sectors.	**DIVERSIFICATION**	An ETF can offer exposure to a single asset class or multiple asset classes. It can also be concentrated or broadly diversified to a geographic region and/or economic sectors.
Typically charges management fees and administration fees to cover the cost of managing the fund and administering all the required records-keeping for investors. Some series of mutual funds also include an embedded commission for financial advisors which increases the cost. For other series of mutual funds, investors pay a fee directly to their advisor based on assets in their account.	**COST OF INVESTING**	ETFs aren't required to hold investor records, so management costs are typically lower as the cost of ownership is carried by the brokerage, not the issuer. There are no embedded commissions with ETFs, but investors typically pay a fee to their broker either for the cost of the trade, the assets in their account, or sometimes both.
Some mutual funds have a preferred pricing - investors are charged a discounted fee when their investment amounts in the fund or fund company crosses a certain level.	**PREFERRED PRICING (COST OF INVESTING)**	ETFs have the same pricing at all asset levels. Given that ETFs are generally lower cost than mutual funds, investors are still ahead on costs.
Typically done monthly for the top 10 holdings, and quarterly for all holdings.	**REPORTING**	Most ETFs provide a daily list of all holdings.
Lump sum or systematic purchase and withdrawal plans allowed at no additional cost. Distributions will generally be reinvested at no cost unless an investor elects to receive distributions in cash.	**PURCHASE OPTIONS**	Lump sum or systematic buying and selling of ETFs can increase the cost of ownership through trading costs. Investors may elect to reinvest dividends manually or automatically, if permitted by the ETF or your brokerage.
Actively managed mutual funds may outperform or underperform an index based on the manager's skill in selecting securities. Fees are typically charged regardless of performance. Mutual funds that track an index provide the return of the index less any fees.	**PERFORMANCE**	For the first generation of market-based ETFs, investors receive the return of the index being tracked less the management fee. Actively managed ETFs will cost more than market-based ETFs and returns can differ from the base market.

MUTUAL FUNDS		EXCHANGE TRADED FUNDS
Investment managers can apply a variety of styles, investment processes and strategies to achieve their objective. Some funds have more risk than other funds depending on their objective and strategies. Risk mitigation strategies come with the benefit of reducing downside risk, but trade off some upside during periods of market growth. More actively managed funds will typically have some risk tied to the market and some tied to its security selection.	**RISK**	An ETF that tracks an index carries the same risk as the index it tracks. The next generation of ETFs include factor-based and actively managed ETFs. These tend to cost more than index-tracking ETFs and carry additional elements of risk for the 'factor' it is tilted towards (e.g. style bias).
Mutual funds each have their own strategy related to currency hedging. Some may be unhedged, others may be fully hedged, so the onus is on the buyer to make a call on currency exchange rate movements. Others use a dynamic currency hedging strategy against the U.S. dollar depending on the manager's view of the direction of exchange rates.	**CURRENCY HEDGE**	ETFs generally have a stated strategy that aims to replicate an index in a given currency, so the onus is on the buyer to make a call on currency exchange rate movements.
Strategies to provide an element of capital protection when markets are negative can be implemented in actively managed mutual funds.	**DOWNSIDE PROTECTION**	Investors in index-tracking ETFs will experience market losses. Actively managed ETFs may provide an element of capital protection depending on their objective.
Mutual funds such as the IPC Essentials Portfolios invest in ETFs to gain broad exposure to the market at a lower cost: it costs less to buy and hold one ETF than it does to buy 100 or more individual securities.	**CROSSOVER**	Second generation actively-managed ETFs now mirror the investment strategies of mutual funds, providing intra-day access to actively managed strategies but often at the same cost as a mutual fund fee-for-service series.

For more information on the IPC Essentials, please visit www.ipcessentials.ca

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