THE STOCK MARKET GAME™ Stock talk

Fund Time

by Bill Dickneider

It happened at the start of a work day in an office high above the noisy traffic of New York City's financial district. Everything on the desk was just as it was the night before – except someone had been using the digital voice recorder during the night. When turned on that morning, the recorder revealed the following unbelievable discussion.

Thoughts to Share

"I suppose we do have something in common," said a mutual fund share. "We both have "fund" in our names.

"Of course," agreed a share of an exchange-traded fund. "We're both shares of investment companies in which many people have invested their savings. Our companies pool the savings and invest the funds in stocks."

"My fund's portfolio consists of large company stocks," bragged the mutual fund. An investor who buys me gets a tiny share of ownership in Exxon Mobil, Microsoft, and many other large companies. Investing in my mutual fund is a great way to own a diversity of large company stocks without having to spend a ton of money buying each stock separately."

"That's similar to my fund's portfolio," boasted the ETF. "It also helps investors diversify their portfolios by spreading their investment eggs among stocks of large companies like Exxon Mobil and Microsoft."

"Investors must like mutual funds a lot more than ETFs," asserted the mutual fund. "There are more than 8,000 different mutual funds compared to fewer than 600 exchange-traded funds. And for every dollar investors have in mutual funds, they have only 4 cents in ETFs."

"Well, mutual funds have been around for decades," answered the ETF. "We just got our start in 1993. But our popularity is soaring for a number of reasons. I trade in the stock market just like a stock. You don't. I can be bought on margin or sold short, you can't. I'm traded from one investor to another, just like a stock. You're not. Investors can only trade you with the mutual fund company itself."

"That makes it easier for investors to trade shares like me," answered the mutual fund. "Mutual funds sell new shares whenever investors want to buy them and redeem shares whenever they want to sell. The number of shares is open-ended, not fixed, so investors never have to worry about finding a buyer or seller."

Price & Net Asset Value

"My price is determined by investors trading in the stock market," said the ETF smugly. "It's just like a stock's price, so it's quoted continually during the trading day. Yours isn't."

"Well, prices of ETFs move up and down during the day, so a trader in the morning might get a different price from a trader in the afternoon," said the mutual fund. "With us mutual funds, all investors pay or receive the same price on a given trading day. After the market closes, the value of a mutual fund's portfolio is added up and the value of its debts subtracted. Dividing the remainder by the total number of shares investors own gives the fund's *net asset value* (NAV). The net asset value, less any trading commission, is the fund's price for all buy and sell orders made that day."

"Well, someone who buys or sells shares of a mutual fund in the morning doesn't really know the price until after the market closes." said the ETF. "Investors who trade shares of ETFs know they'll get the price quoted at that time."

"But there can be a difference, or spread, between the price a buyer is willing to bid for an ETF share and the price a seller is willing to accept," explained the mutual fund. "So an eager trader might end up with a price that's worse than the one desired. What's more, investors can buy shares directly from a mutual fund, and many of them don't charge commissions. Since you're traded in the stock market, investors have to buy or sell you through brokers and pay their commissions."

"Most investors go through brokers when trading shares with a mutual fund," answered the ETF, "so they pay commissions after all. Many mutual funds also have costs that most ETFs don't have. Some charge "loads" when selling or redeeming shares to cover expenses for marketing the funds to investors. And while mutual funds and ETFs both have annual management expenses, these fees are often higher for mutual funds."

Number & Type of Funds

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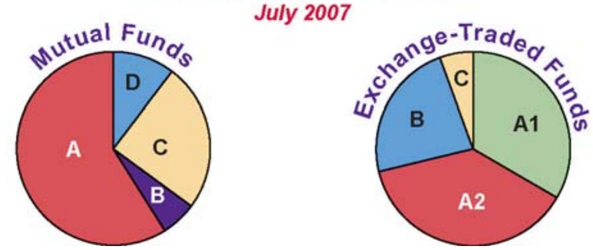

A. Stock funds	4,721
B. Stock & bond funds	480
C. Bond funds	1,987
D. Money market funds	828
Total Mutual Funds	**8,016**

Source: *Investment Company Institute, www.ici.org.*

A. Domestic stock ETFs	
1. Broad-based	180
2. Specific sectors or industries	204
B. Global/international stock ETFs	125
C. Bond ETFs	30
Total ETFs	**539**

For a discussion of mutual funds and exchange-traded funds, see the following sources from the Investment Company Institute:

A Guide to Understanding Mutual Funds, http://www.ici.org/statements/inv/bro_understanding_mfs.html#TopOfPage;

Frequently Asked Questions about Exchange-Traded Funds, http://www.ici.org/funds/abt/faqs_etfs.html#TopOfPage;

"There are good reasons for our higher management fees," snapped the mutual fund. Most mutual funds have professional managers who pick stocks and actively manage them to get better returns for investors.* So the higher costs are worthwhile when they produce even higher returns. You ETFs only follow particular market indexes, like the S&P 500. You don't have professionals actively managing your portfolios to get superior returns, so your annual management fees *are usually lower*...."

The recording faded away, and the rest of the amazing discussion was lost.

Write Now

Pick one of the following and write a paragraph to explain your answer.

If you were investing in a fund, would you choose a mutual fund or an exchange-traded fund? Explain.

Use the web sites above to describe the different types of mutual funds or exchange-traded funds listed in the table.

* Some mutual funds are index funds that track particular market indexes just like ETFs. These funds also have relatively low management expenses.

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