New Investors: Should You Buy ETFs or Stocks?

Description

An exchanged-traded fund (ETF) traditionally tracked an index. Now they cover domestic and global equity and fixed-income markets. For example, **iShares S&P/TSX 60 Index Fund** (TSX:XIU) is an ETF that tracks the S&P/TSX 60 Index, which is comprised of the 60-largest companies by market cap in the S&P/TSX Composite Index.

Whether you decide to invest in ETFs or stocks, you should know what you're investing in. For example, before investing in the iShares S&P/TSX 60 Index Fund, investors should be aware that its sector weighting mirrors that of the S&P/TSX Composite Index. That is, it's weighted heavily in financials and energy. Specifically, its financial-sector weighting is about 38.3% and its energy-sector weighting is roughly 18.4%.

You might want to manage your portfolio such that it has as little overlap as possible, so if one sector doesn't do well, another might be chugging along fine. For example, the energy sector has performed badly in the last year because of low energy prices.

ETFs are great for instant diversification. It's probably cheaper to invest in ETFs than stocks because each stock purchase requires a transaction fee. ETF investing should also take less time.

What about stock investing?

If you have more time on your hands and the interest to do so, you might want to invest in individual stocks. Doing so gives you more control.

For example, you might not like the huge financial and energy exposure in the iShares S&P/TSX 60 Index Fund. Instead, you can buy some shares of **Royal Bank of Canada** (TSX:RY)(NYSE:RY), which is the fund's biggest holding with about an 8.5% weighting. (If you have a $10,000 portfolio, an 8.5% weighting equates to $850.) Instead of that weighting, you can choose a 5% weighting and buy $500 worth.

Royal Bank also pays a higher yield than the fund, which pays a 3.2% yield. However, the two investments can't really be compared like that. To clarify, Royal Bank is only one company, but the fund gives you exposure to 60 companies, although you might not like all 60 of those companies.

Conclusion: Which should you choose?

ETF investing is a low-cost way to invest (typically less than 0.50%). There are many ETF choices for specific industries and even bonds. You can get started with smaller amounts than it would take to build a stock portfolio, and still be diversified.

Building a stock portfolio takes more time and costs more in transaction fees. However, if you're interested in managing your portfolio, it can be very rewarding. Investors who choose this route should be ready for continuous learning as they gain real-life experience in investing. Perhaps starting with a virtual brokerage account for practice and getting a "feel" of the market is not a bad idea.

If one of your goals is to get higher income from your investments, then investing in individual stocks allows you to choose the ones with stable earnings and cash flows, which pay above-average yields that are safe and may be growing.

Of course, you can have the best of both worlds and invest in select ETFs and individual stocks as a part of your portfolio.

CATEGORY

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2. Dividend Stocks
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4. Stocks for Beginners

POST TAG

1. Editor's Choice

TICKERS GLOBAL

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2. TSX:RY (Royal Bank of Canada)
3. TSX:XIU (iShares S&P/TSX 60 Index ETF)

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