3 Tips for New ETF or Mutual Fund Investors

Description

Good job on saving money! New investors may think of investing in exchange-traded funds (ETFs) or mutual funds for immediate diversification, or perhaps you simply don't want to pick individual investments like specific stocks or bonds. How do you choose between ETFs vs mutual funds, though? Typically, mutual funds are actively managed. So, mutual funds will most likely cost more to hold for investors. You won't see the costs, because they'll be deducted from the returns.

Get diversification

As **Blackrock** explained, driven by investor demand and technology improvement, there are now a variety of ETF offerings. The most common ones are equity ETFs that provide exposure to stocks and bond or fixed-income ETFs.

Warren Buffett recommends the layman investor invest in the **S&P 500** index fund and simply average in it over time to get market returns (minus the small management expense ratio) for the long-term goal of retirement with much less effort. Since the market-wide index ETF provides exposure to the largest 500 U.S. companies, it is expected to rise over time and deliver satisfactory returns.

The idea of dollar-cost averaging is to buy more shares when the market is down and fewer shares when it goes up. The S&P 500 is better for immediate diversification as a long-term holding than the Canadian market-wide ETF, because the latter is typically weighed more heavily in the financials and energy sectors.

The long-term average market returns have been about 7-10%. Assuming an annual 7% return, monthly investments of $500 over 30 years will transform into $566,764.

ETFs and mutual funds can be volatile

ETFs and mutual funds can provide much greater long-term returns than putting money in your savings account or GIC. However, they are also susceptible to volatility, just like their underlying assets, such as stocks, bonds, etc. Investors should know what kinds of funds they're investing in and understand the risks and volatility they can bring.

If you know you'll need to spend your money within a year, place it in something safer, like a high-interest savings account or GIC instead of in equity ETFs or mutual funds. For a guide as well as model portfolios for index/ETF investing, check out the Canadian Couch Potato website.

Funds typically take turns shining

If you choose to invest in specific areas of the market through ETFs or mutual funds, you will notice that they'll take turns being in and out of favour — often over years at a time. For example, the biotech ETF **SPDR S&P Biotech ETF** generated exceptional returns from 2012 to the summer of 2015. Then it came crashing down in early 2016. After that, it had a nice run through the summer of 2018 before correcting and then consolidating. Then during the pandemic in 2020 and 2021, the ETF doubled investors' money from trough to peak.

If you go through a decade's history of the performance of other funds, you'll probably see a similar story. This is why Buffett recommends averaging into the S&P 500, which doesn't require any thinking on your part. You only need to be disciplined in your savings and follow the plan through thick and thin. That said, if you know certain areas of the market are trading at a discount today, it makes sense to gain exposure to those areas. Perhaps it would be a high-growth ETF like **ARK Innovation ETF**.

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Date
2025/07/26
Date Created
2022/01/24
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