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8 GREAT BENEFITS OF MUTUAL FUNDS

There are many advantages of mutual funds. Here are eight reasons to add mutual funds to your portfolio.

By: Coryanne Hicks - September 19, 2019

Do mutual funds belong in your portfolio?

Mutual funds are among the most popular investment vehicles in the U.S. Nearly 100 million Americans own mutual funds, fueling an industry that is more than $50 trillion, according to the Investment Company Institute. Mutual funds win the investment popularity crown for good reason: They're easy to buy and sell, widely available and designed to help investors reach their long-term financial goals. But this is only the beginning of the benefits mutual funds provide. Here are eight benefits of mutual funds that prove this bandwagon may be a good one on which to jump.

Diversification at every dollar level.

Diversification is a primary aspiration of many investors, but it can also be a major challenge, especially for smaller accounts. "Diversifying your investment significantly lowers the risk associated with a single investment performing poorly," says Scott Butler, a financial planner at Klauenberg Retirement Solutions in Laurel, Maryland. The beauty of mutual funds is every dollar you invest is diversified. "When you invest in a mutual fund, your money is pooled with the money of all the other investors in that fund," Butler says. This allows the fund to buy dozens, hundreds or even thousands of different investments. Every dollar you invest is then allocated proportionately across all of these investments. Translation: instant diversification.

Sharing of investment expenses.

Anyone who's ever had a roommate knows the power of shared expenses. An expense shared is an expense halved. By pooling their assets with others, mutual fund investors cut their investing expenses. "Mutual fund shareholders share the expenses of the fund proportionately based on the amount they have invested," Butler says. When buying individual stocks, you're responsible for all transaction costs on your own. These costs can add up, especially if you want to buy shares in small quantities or dollar-cost average. "You will also be dealing yourself with bid-ask spreads, buying stocks based on their higher ask prices and selling stocks based on their lower sell prices," Butler says. In a mutual fund, it's up to the fund manager to juggle these financial hurdles, which are easier to manage in a fund with the resources to buy in bulk.

Economies of scale and operational efficiencies.

Bulk shopping is yet another advantage of pooling investors' funds. Thanks to their size, mutual funds are able "to take advantage of economies of scale and operational efficiencies in trading," says Razmig Der-Tavitian, director of manager research at Highmark Capital Management, MUFG Union Bank's wholly-owned investment advisory firm. This makes mutual funds better suited to "transact in local international markets, trade assets with unique complexities such as bank loans (and) enter counterparty agreements." Even exchange traded funds (ETFs) struggle to address such complexities, Der-Tavitian says.

Easier to invest in specialized market sectors.

With their knack for tackling complex investing strategies, mutual funds can be an excellent way for investors to get exposure to specialized market sectors or geographic regions at lower cost. "Specialty mutual funds can provide investment exposure to a market sector or geographic region with a single investment, whereas achieving that exposure with diversification in a separately managed account (SMA) is logistically difficult and incurs significant trading costs," Meadows says. Not to mention it often takes a large investment to set up an SMA. International and specialty mutual funds usually come with a fraction of an SMA's investment minimum.

Easy to access and track.

Few investments, if any, are easier to buy than a mutual fund. While most SMAs require an intermediary to access, investors can buy mutual funds themselves in a self-directed brokerage account. And with their low investment minimums, "mutual funds are easy to purchase for virtually any type of investor, even at a small scale," Der-Tavitian says. The low minimums can help investors diversify across fund managers, too. Mutual funds are also regulated, "reducing both operational and investment risk." Likewise, since mutual fund information is widely accessible, investments in mutual funds are "easier to both source and monitor," Der-Tavitian says.

Simplified portfolio management.

Another area where mutual funds outshine even SMAs is in their ease of portfolio management. Changing your asset allocation, investing new contributions or selling positions can be done in a single transaction with a mutual fund, Meadows says. An SMA, on the other hand, must "make a transaction in each individual security." This can be far more time consuming and result in higher trading costs. "While a SMA has its benefits for larger-scale investors, mutual funds provide most of the benefits that an institutional SMA can reap in a competitive cost structure," he says.

Access to professional money managers.

While the debate over the merits of ETFs versus mutual funds rages, one area where mutual funds come out ahead is in the variety of fund management styles available. ETFs seek to provide passive exposure to an asset class or geography, Der-Tavitian says. "In contrast, mutual funds offer investors access to active strategies and the benefits of professional money management: a professional money manager that is making decisions around security selection for the fund." So rather than blindly following a benchmark index, mutual fund investors can get the expertise of a professional for far less than the cost of hiring an individual financial advisor.

Low trading costs.

Mutual funds trading costs are also lower than those for ETFs. Mutual funds always trade at net asset value (NAV), or the market value of its assets minus liabilities divided by the number of shares owned by investors. This has two benefits, according to Der-Tavitian: First, it means "mutual funds are not subject to a bid/ask spread." With only one price per day, mutual fund traders all buy and sell at the same price. And since that price is NAV, they never have to worry about if they're paying a premium or discount for the fund. ETFs, on the other hand, can and frequently do trade above or below NAV. "Smaller ETFs with lower trading volumes are even more susceptible to wider bid/ask spreads and premiums or discounts to NAV," Der-Tavitian says.

The top benefits of mutual funds.

- Diversification at every dollar level.
- Sharing of investment expenses.
- Economies of scale and operational efficiencies.
- Easier to invest in specialized market sectors.
- Easy to access and track.
- Simplified portfolio management.
- Access to professional money managers.
- Low trading costs.

Scott Butler, CRC, is a financial planner with Klauenberg Retirement Solutions. Using his background as a former teacher, Scott breaks down financial topics to levels that clients can more easily understand, believing each person should have a basic understanding of the wealth strategies and products that work for them.

To contact Scott, call 301-317-0401 or visit KlauenbergRetirementSolutions.com