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ETFs top mutual funds in popularity

'Tax-efficient' fund seen as more stable

By Tim Grant
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Mutual funds have for decades been the undisputed heavyweight champions of the investment world with more than $16 trillion in combined assets. But their main rival — exchange traded funds, which came onto the scene in 1989 and boast about $2 trillion in assets — has been gaining ground.

As an investment vehicle that financial advisers use and recommend, exchange traded funds — also known as ETFs — now surpass mutual funds in popularity, according to a recent survey conducted by the Journal of Financial Planning and the Financial Planning Association Research and Practice Institute, both in Denver.

The survey, which included 303 financial advisers nationwide, showed 81 percent of those polled currently use or recommend ETFs for their clients — the most popular investment vehicle among 17 options. Mutual finds were used or recommended by 78 percent of advisers surveyed.

"There is a lot to like about ETFs," said Valerie Chaille, president of SummitView Financial in Indianapolis and a consultant with the Financial Planning Association. "They are low-cost, tax-efficient and very liquid. They can be traded throughout the trading day [like individual stocks] and the holdings are transparent.

"Mutual fund holdings can change often," she said, adding that mutual funds also are priced only at the end of a trading day. "At any given time, you may not necessarily know what the exact holdings in a mutual fund are. With an ETF, the holdings don't change unless the index it tracks changes."

Exchange traded funds track specific sectors of the investment world, such as the S&P 500, the energy sector, the Russell 1000, gold, silver, or foreign investments. Mutual funds pool money from investors to be professionally managed by money managers.

According to the Washington, D.C.-based Investment Company Institute, total net assets in exchange traded funds reached $2.1 trillion in April. Mutual fund assets totaled nearly $16.2 trillion that same month.

Nicholas Besh, director of the asset management group at PNC Bank, Downtown, said he recommends both investment tools based on individual client's circumstances.

"ETFs have lower fees because they are not actively managed," Mr. Besh said. "They also are typically more tax-efficient."

Mutual funds are better suited for clients who want an investment that has a better chance of outperforming the market, since they are actively managed by fund managers.

ETFs are a better option for clients who may run a business or have other investments that generate substantial realized capital gains and may not want their investment portfolio to have any capital gain surprises. The cost basis for an exchange traded fund is what you pay for it.

"The holdings in a mutual fund is determined when the mutual fund bought the holding, not when you bought the mutual fund," Mr. Besh said. "If you bought the mutual fund today, the fund could sell a stock tomorrow and that gain would be distributed to you even if the fund owned the stock three years and you owned it for one day."

P.J. DiNuzzo, president of DiNuzzo Index Advisors in Beaver, said his firm is the oldest pure index manager in the Pittsburgh region. Indices have been on the investment landscape long before ETFs.

Mr. DiNuzzo said his firm has always used indices as opposed to mutual funds, starting with the Vanguard Index since 1989. "The reason ETFs are becoming a more popular investment vehicle is due to the growing popularity and the increased use of indexes," he said, "and the benefits and appreciation of very low expenses."

Tim Grant: tgrant@post-gazette.com or 412-263-1591.