FINANCIAL DICTIONARY: PART TWO

In our last issue, we discussed the very basics of stocks, bonds, and portfolios. In an effort to extend our financial dictionary, we will expand on the basics with mutual funds, exchange traded funds (ETFs), and returns.

Mutual Funds:

A mutual fund is a collection of securities held in a portfolio owned by multiple people. Investors can purchase shares or units of a mutual fund to add to their own portfolio, the fund managers then use this money spent in the purchase to buy more stocks or bonds to hold within the mutual fund. Based on how the underlying securities perform, your shares in a mutual fund might go up in value or down. Additionally, as the stocks pay dividends, or the bonds pay interest, you would be paid your portion of the income generated by the fund, just like all the other hundreds or thousands of owners of this fund.

Generally, mutual funds have a mandate that they follow. They could invest in exclusively oil and gas stocks, or retail stocks, or high yield bonds. They could be focused on any number of specific market sectors or they could be very general in their approach to investing.

In owning a mutual fund, you would pay fees mostly for the expertise that the fund managers provide. The investment decisions they make on your behalf will hopefully be beneficial to you and will justify these fees. On average, a mutual fund might charge 1-3% for the expertise of its fund managers.

Exchange Traded Funds (ETFs):

As the mutual fund industry has evolved, ETFs have gained popularity among many investors. The main difference between an ETF and a mutual fund is that ETF's shares or units, trade much like a stock on a stock exchange rather than dealing directly with a fund company. Traditionally, an ETF mirrors an exchange index, like the TSX 60, which is made up of the 60 largest public companies in Canada. An investor might look at these companies and be interested in investing in each of them, but not have the money available to do so. Instead, that investor could purchase shares or units of an ETF that matches the TSX 60, giving them the ability to diversify into all those stocks without having to buy shares of all 60 companies.

Usually, because there are no investment decisions being made by the fund managers, ETF's charge lower fees than mutual funds. An investor might expect to pay 0.2-1% in an ETF. This fee would pay for the administrative caretaking of the fund.

Bonus: For most investors, an investment portfolio would be made up of the four security varieties we have discussed thus far: stocks, bonds, mutual funds, and ETFs. In future issues, we will explore some of the subsets of these securities and how they can fit into an investment portfolio.

Return:

The return is the total money made (or lost) on an investment or portfolio of investments. This could include the income you have earned in the form of dividends and interest, and the change in the price of your securities. Return can be expressed as a dollar figure or as a percentage of the assets you started with. For example, if you invested $1,000 into a stock, and over the next year it gained in value to $1,200 your return is either $200 or 20%.

It is important to understand exactly what is being included in the return you see on a statement. Is that return including the deductions for fees or commissions you have paid, does it take into account the changes you have made to your account through deposits or withdrawals etc.

If you have any suggestions for future definitions, or have any questions about those discussed in this issue, please contact me at Harrison.kozak@cibc.com or 403 260-0566.

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