Money Unscripted

TRANSCRIPT

SPEAKERS:

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4 easy investing ideas for beginners

ALLY DONNELLY: Ready to invest but not sure where to put your money? Let's make it easier. We've got four simple investing ideas to help you get started. This is *Money Unscripted,* Fidelity Investments' personal finance podcast, with Fidelity VP and Financial Consultant, Ryan Viktorin, and me, Ally Donnelly. Today we're making sense of investment funds: how they work, how they're different, and how to figure out which one could be right for you.

Ryan, if I'm someone who wants to invest, but maybe I want more of a hands-off strategy, or maybe I'm intimidated by the whole thing, why might I want to consider investment funds?

RYAN VIKTORIN: Well, investment funds are a fantastic way to try to invest. And they're designed for people who say, I don't know which stock to pick or which bond to pick. And so, it lets you have a little bit of less hands-on approach, less overwhelming type of strategy. And this is what we talk about all the time. It's totally normal to feel a little overwhelmed by it.

ALLY: All right, big picture. What's the difference between a stock and a fund?

RYAN: Stocks are a slice of a company that you own when you buy it. And your performance, how you do with that investment, goes up and down with the performance of that one company. You own a slice of it.

ALLY: OK.

RYAN: I also want to add something in here, which is what a bond is. When you buy a bond, you're actually buying a loan. You're loaning a company money. You get interest along the way and generally get your money back after a certain period of time that's preset when you buy the bond.

The reason I bring that up is because funds, which are pooled investments, invest in stocks or bonds, or a little bit of both, depending on really what you're going for the fund. And it's actually a common misconception that funds are stock funds, but they can actually be either or.

ALLY: All right, so what are the pros and cons of investing in stocks versus funds? Talk me through some of the trade-offs.

RYAN: Well, funds in general can be more diversified. So rather than investing in one stock, like I said before, and all your performance is tied to that one stock, funds can be much more diversified. There can be dozens or hundreds of stocks inside of that fund. And that gives you less what we call "concentration risk," which might be a little too much of one thing for your performance.

Sometimes individual stocks do incredibly well, and they just kind of [WHOOSH] straight up. And there's actually a common misconception that you have to invest in individual stocks to really build wealth over time. But you can potentially create real wealth with funds as well. The other thing to be mindful of is that if you do want to go trade stocks, online stock trading is commission-free at Fidelity, versus a fund might have an ongoing expense ratio, an ongoing cost as you own it along the way.

ALLY: So today, we're going to talk through four different kinds of funds: mutual funds, index funds, target date funds, and ETFs. Let's start with mutual fund. What is a mutual fund?

RYAN: So the easiest way, I think about this is that a mutual fund is a lot of investors pool their money together to invest in either stocks or bonds. And it's managed by a team of what's called portfolio managers to create a mutual fund when you invest. And again, like I said they can be a more hands-off, less overwhelming and diversified option.

Now, this is where I have to bring in some of the misconception and really why there's a root of confusion sometimes in this category. Because target date funds and index funds are types of mutual funds, which is, I can understand why clients can be a little bit confused about all of this.

ALLY: Yeah, yeah.

RYAN: So the easier way that I think about it is, what is an actively managed strategy versus a passively managed strategy? And it gets easier to understand from there.

ALLY: OK, actively managed versus passively managed. What do I need to know there?

RYAN: So I'm going to start with passively managed, because it's actually the most straightforward. Passively managed investments aimed to just track along with whatever the underlying investments are. So, let me give you an example to make it easier to understand.

Let's say you just want to participate in the US total stock market. So, whatever the stock market does, up, down, sideways, whatever it is, you just want to participate in that.

ALLY: OK.

RYAN: That's a passive strategy. And it's actually pretty straightforward to do, because if a stock is in the large cap US stock market, it's in the index funds. It's pretty straightforward. And because it's pretty straightforward, it tends to have lower fees associated with it.

ALLY: OK.

RYAN: Passively managed funds are commonly referred to as index funds.

ALLY: OK, OK.

RYAN: Then there's actively managed funds. Actively managed funds want to try to beat an index. So they might have more or less of a certain company, avoid certain companies in all these stocks and these investments, again, to try to beat the index.

ALLY: It takes more work.

RYAN: It takes more work. There's a lot that goes into it. There's a lot of research. There's a lot of analysis to figure out what to invest in and what not to invest in. So, those can have a little bit higher, like I said before, expense ratios or costs affiliated with them, because there's so much more that goes into it. Now, actively managed funds tend to be referred to as mutual funds. So, you can see where some of the confusion starts to come in between the two.

ALLY: So, the difference between a mutual fund and an index fund is how they're managed?

RYAN: Correct. Index funds are passively managed. They just aim to track along. Mutual funds tend to be actively managed to try to beat the underlying investment, even though index funds are types of mutual funds.

ALLY: OK. All right, so we've established that an index fund is a type of mutual fund. But how do I decide on mutual fund versus index fund when it comes to investing?

RYAN: Well I think this is a cost versus performance type of decision. Sometimes it's really common to say, oh, I just want whatever the lowest fee is, and that's what I want. And that's fine if that is what you do want. But when you're making a decision between an index fund or a mutual fund or, like I said, a passive investment versus an active investment, yes, the costs are incredibly important to consider, but so is the performance.

If you have a fund that has a higher expense ratio or cost tied to it but the performance is much better than the underlying index fund, you could see why you'd want to make that investment. So, you obviously want to be mindful of what the costs are, but you also want to be mindful of how the fund has actually done.

ALLY: Sure.

RYAN: And we have a great tool called the Mutual Fund Evaluator that can help you look at the performance, the risk, the fees tied to it, and it's a great tool to use online. And if you don't know where to start, the Mutual Fund Evaluator offers up some sample criteria that you can search for, like, are you looking for a fund that offers potentially higher returns that might be potentially riskier, has lower expenses, has a manager to beat the benchmark, or could even help fight inflation? You enter your answers in, and the evaluator will provide funds that fit that criteria.

ALLY: So, what is a target date fund?

RYAN: So, a target date fund is actually a mix of investments, stocks, bonds maybe even cash, that's tied to a year in the future. And if you have a 401(k) or even a 529 account, chances are you have had and might even own right now a target date fund.

But let me give you an example to bring this to life. Let's say you're 30 years old, and you're investing for your retirement. Let's even say it is in your 401(k). And it's for 30, 35 years from now, and you pick a target date fund tied to that year.

ALLY: A target date.

RYAN: Target date, yeah, exactly. So, it starts a little bit more aggressive. That means more stock, because you have 30, 35 years to go until you actually reach that date. And stocks tend to grow over time, so you have time to go up and down with the market with the hopes of having growth over that time period.

But as you approach that date, it actually can get more conservative. That means a little bit more bonds. It means a little bit more stable, because you're a lot closer to that date now, so you got to—

ALLY: And you may not want to take that risk.

RYAN: Exactly. You may not want to take as much risk.

ALLY: What are some of the pros and cons of target date funds?

RYAN: Well, I love target date funds, especially inside of a 401(k), because you make a decision for the year, and then you purchase it, and then you're done pretty much. I exaggerate, but it's just kind of on autopilot. It's kind of designed to just sit there and do its thing. It's going to get, like I said, more conservative, more stable over time. It's going to rebalance for you. You don't have to go in and do the day-to-day.

Now, just because it's done for you doesn't mean we don't check in on it and make sure that it's still the right investment, given whatever your time frame is. And that gets way more important as you approach that year—

ALLY: Yeah, of course.

RYAN: —for the target date fund.

ALLY: Let's move on to our fourth fund. What is an ETF?

RYAN: Yes, an ETF is an exchange-traded fund. And very similar to a mutual fund, it's pooled investments that invest in the underlying securities like stocks or bonds. And they, too, can be actively managed or passively managed.

ALLY: You say similar, but mutual fund versus ETF: what's the difference?

RYAN: Yeah, the fundamental difference between an ETF and a mutual fund is when it trades throughout the day. So if you place a trade, let's say at 10:30 in the morning for a mutual fund, it still will not trade until the end of the day. If you place a trade for an ETF or an exchange-traded fund at 10:30 in the morning, it'll trade at 10:30 in the morning.

ALLY: Why do I care what time it trades?

RYAN: Sometimes people really want to know what—they see a price, they get it, and they want it at that time.

ALLY: So, with an ETF, you're locked in?

RYAN: Yes, exactly. Now, there's one other thing to add is that ETFs can potentially be more tax-efficient than mutual funds.

ALLY: If you're looking for tax basics on ETFs, we'll put a link in our show notes. All right, so Ryan, if I'm interested in one of these funds, what are my next steps.

RYAN: So first of all, you have to open an account. Second, you have to fund the account, so that means put money into the account. Now, then have to obviously do the research that we're talking about. Decide how you want to invest, what type of fund it would actually be. And then you actually have to go and buy that investment.

Sometimes people think they put the money into the account, and they're done, but it's actually you have to go and invest in the thing. So you have to make a trade to go and buy what you want.

ALLY: All right, so how do I choose which of these funds is right for me?

RYAN: Yeah, this is all tied to your goals, and that's always where I start. What are the important things that you're trying to accomplish? When are they all happening? And then you can try to decide what's most appropriate for whatever that goal is.

But then also, you want to think about, do you want to focus on something that's lower cost? Do you want it to be actively or passively managed, or a little bit of both? Also, you want to consider your risk tolerance. So, do you want to be a little bit more aggressive? Do you want to be more conservative? And how do you feel about that? It's an important consideration.

The other thing that's really important to know is, this is what we're here for, to help with. This is what I talk about all day. And so, you don't have to figure this out all on your own. You can absolutely reach out to us for help.

ALLY: All right, so as we're walking away from this conversation, bottom line?

RYAN: So, the bottom line is there's no one-size-fits-all to investing or even which of these funds that you have. You can have a little bit of everything, and you can try to make it really diversified for what you're comfortable with. And the other bottom line I have to add—I have three bottom lines, OK?

The first is obviously not one-size-fits-all, but the second is sometimes there's this common misconception that you have to have a lot of wealth to actually get some help or even invest in these things, and it's just not true. You can just do it really at any time.

The other thing that I have to say—it's not too late. It's never too late to get started. Even if you're well into your career and retirement is close, it's never too late. So, just start, and please reach out for help.

ALLY: I love it. I love it. Ryan, thank you so much!

RYAN: Thanks for having me.

ALLY: Whether you're ready to open an account, pick a fund, or maybe you're looking to do a little bit more research, we've got you covered. Check out the links in our show notes or head to our website. It's Fidelity.com/MoneyUnscripted.

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