09.02.25 | FINANCIAL LITERACY

Mutual Funds vs. ETFs: What They Are and How They Differ

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When it comes to investing, you don't have to pick individual securities to build a solid portfolio. Mutual funds and exchange-traded funds (ETFs) are two popular ways to invest in a ready-made mix of stocks, bonds, or other assets, helping you spread your risk without the hassle of choosing each investment yourself.
While they seem similar, mutual funds and ETFs differ in how they are bought, sold, priced, and taxed. Whether you're saving for retirement, planning a large purchase, or simply looking to grow your wealth, it's helpful to understand how these two options compare so you can choose what's right for you. Let's take a closer look at how mutual funds and ETFs work, what makes them different, and how each one might fit into your investment plan.

MUTUAL FUNDS

Mutual funds aren't traded on stock exchanges. Instead, you buy and sell them directly through the fund company, your 401(k) provider, or a brokerage (such as Fidelity, Schwab, or Vanguard etc.).

Mutual fund prices are only set once per day, after the market closes at 4 p.m. ET. The price you pay is known as the Net Asset Value (NAV), which is calculated by taking the total assets minus the liabilities and dividing it by the number of shares outstanding. Regardless of when you place your order, you'll receive the fund's closing price for that day.

Example:

Suppose you order $1,000 of a mutual fund at 10 a.m. when the price per share is $100. You would expect 10 shares ($1,000/$100). If the price rises to $102 by 4 p.m., you'll receive about 9.8 shares instead ($1,000/$102).

Mutual funds are often used in workplace retirement plans like 401(k)s because they're structured for long-term investing and offer features like automatic contributions and reinvestment of dividends.

ETFS

ETFs, or exchange-traded funds, trade on stock exchanges just like individual stocks. You can buy or sell them at any time during the trading day, and their prices change throughout the day based on supply and demand.

Unlike mutual funds, ETFs have prices that move continuously while markets are open. When you place an order, you'll typically get the current market price at that moment.

Example:

If you buy an ETF at 10 a.m. for $100 per share and check again at 3 p.m., the price might be $101 or $98 depending on market activity.

Many investors like ETFs for their flexibility, transparency, and wide range of investment styles. They're easy to trade through a regular brokerage account and show their holdings daily, so you always know what's inside.

Most ETFs tend to follow passive investing strategies, such as tracking a market index like the S&P 500, but the ETF landscape has evolved over the years. Now, there are ETFs that follow smart beta or active index strategies, where the underlying index can be adjusted periodically based on specific factors like momentum or volatility. There are also more targeted ETFs, like leveraged or inverse ETFs, which aim to amplify daily returns of specific indices or move in the opposite direction of the market.

These more predictable structures are part of the reason ETFs trade throughout the day and reveal their holdings daily, offering both transparency and liquidity for investors. To learn more about passive vs. active management styles, check out our "Active vs. Passive Management Styles" article.

COMPARING MUTUAL FUNDS AND ETFS SIDE BY SIDE

Mutual funds and ETFs share similarities, but they also have important differences in how they work, how you buy and sell them, and how they affect your taxes. To help make these differences clearer, here's a side-by-side look at how mutual funds and ETFs compare:

	Mutual Funds	ETFs
Trading	Bought and sold once daily after market close at a single price (NAV).	Trade throughout the day like stocks, with prices changing minute by minute.
How You Buy	Purchased directly from the fund company, a brokerage, or through a retirement plan.	Purchased through a brokerage account on stock exchanges.
Price Changes	Priced once per day after markets close.	Prices fluctuate all day while markets are open.
Minimum Investment	Often requires \$500–\$3,000 or more to start.	Can purchase as little as one share.
Transparency	Holdings usually reported quarterly.	Holdings usually disclosed daily.
Can Hold the Other?	Mutual funds can hold ETFs as part of their portfolio to gain exposure to certain markets or strategies.	ETFs generally do not hold mutual funds because it complicates their trading structure.
Tax Efficiency	Less tax-efficient because managers may sell holdings, creating capital gains that are passed on to investors—even if you didn't sell your own shares.	More tax-efficient due to unique "in-kind" redemption processes that reduce capital gains distributions. Less likely to surprise you with a tax bill.

WHICH ONE'S RIGHT FOR YOU?

Choosing between mutual funds and ETFs depends on your investing style, goals, and how involved you want to be in managing your investments. Here's a simple way to think about it:

Mutual funds may be better if you:

- Prefer a hands-off approach and want a professional to manage your investments.
- Are investing in a 401(k) or other workplace retirement plan, where mutual funds are often the default option.

ETFs might be better if you:

- Like the flexibility to trade during the day.
- Are investing in a taxable brokerage account and want potentially better tax efficiency.

Remember, there's no single "right" choice–it depends on your goals, comfort level, and how hands-on you want to be. The key is choosing investments you understand and feel comfortable with.

THE GRIMES PERSPECTIVE

Mutual funds and ETFs are both excellent ways to build a diversified portfolio without having to pick individual stocks or bonds. While one might fit your situation better, you don't necessarily have to choose just one. Many investors use mutual funds for retirement savings and ETFs for personal brokerage accounts.

In simple terms, mutual funds are great for set-it-and-forget-it investing, while ETFs offer more flexibility and often lower costs. Both types can be held long-term and used to help you reach your financial goals. And while ETFs trade during the day, you don't have to watch them constantly; many investors buy and hold them just like mutual funds.

One thing to keep in mind with both mutual funds and ETFs is fees. Mutual funds are typically actively managed, which often results in higher expense ratios compared to ETFs, which are usually passively managed due to their nature of tracking an index. Being mindful of how much you're paying in fees and strategically planning the mix of mutual funds and ETFs is known as "fee budgeting." It's a valuable step in ensuring your investment strategy remains cost-efficient and aligned with your long-term financial goals.

If you're not sure which is right for you or simply want help understanding how these choices fit into your bigger financial picture, talk with your Grimes financial advisor.

This article is part of an ongoing series aimed to help build overall financial literacy, and was co-authored by Grimes & Company's Financial Planning Associate Matthew Licata. While not a comprehensive deep dive into every single topic, it is designed to provide a helpful overview to key topics within the world of investing and financial planning. Please reach out to connect *with an advisor or expert on the subject to learn more and start planning for your financial future.*