Understanding the Difference Between Mutual Funds and ETFs

Mutual funds and exchange-traded funds, commonly called ETFs, can both make it easier to invest in a collection of securities rather than purchasing every stock or bond individually. That shared feature often makes the two sound interchangeable.

They aren't.

Mutual funds and ETFs differ in how they're priced, bought, sold, managed, taxed, and used within a portfolio. Those differences can affect investment costs, risk exposure, cash flow, and long-term financial planning.

At **Intermountain Wealth Management**, we help individuals, families, university professors, retirees, pre-retirees, and business owners make investment decisions within the context of their complete financial picture. Through professional investment management, we evaluate funds based on what they hold, what they cost, how they behave, and how they support each client's goals.

What Is the Main Difference Between Mutual Funds and ETFs?

Mutual funds and ETFs both pool money from multiple investors to purchase a portfolio of assets. Depending on the fund, those assets may include stocks, bonds, short-term investments, commodities, or a combination of holdings.

The primary difference is how shares are traded.

Mutual fund shares are generally purchased or redeemed directly through the fund at a price calculated after the market closes. ETFs trade on stock exchanges throughout the day at changing market prices.

That distinction influences several other features, including:

- When trades can be completed
- How prices are determined
- Whether minimum investments apply
- Which fees investors may pay
- How tax consequences may arise
- How the fund fits into a managed portfolio

Neither structure is automatically better. A fund's value depends on its underlying investments, strategy, expenses, risk, and role within the broader plan.

Our financial planning process helps connect these investment details to retirement goals, income needs, taxes, family priorities, and other financial decisions.

How Mutual Funds Work

A mutual fund combines money from many investors and uses it to purchase a portfolio of securities. The portfolio is managed according to an investment objective described in the fund's prospectus.

Some mutual funds focus on broad sections of the market. Others invest in a particular industry, company size, geographic region, bond category, or investment style.

A mutual fund may hold:

- Domestic or international stocks
- Government or corporate bonds
- Short-term money market instruments
- A mixture of stocks and bonds
- Securities that follow a particular index
- Assets selected by a professional management team

Each investor owns shares of the fund rather than directly owning each security in the portfolio. The value of those shares is based on the fund's **net asset value**, often abbreviated as NAV.

A mutual fund's NAV is typically calculated once per business day after the financial markets close. Investors who place orders during the day generally receive the next calculated NAV rather than a price visible at the exact moment the order is submitted.

How ETFs Work

An ETF also pools investor money and holds a portfolio of assets. However, its shares are listed on an exchange and trade throughout the day in a manner similar to individual stocks.

An ETF's market price can change from one trade to the next. Investors may generally place market orders, limit orders, and other order types during trading hours.

Because ETFs trade on an exchange, their market prices are influenced by supply and demand. An ETF may temporarily trade above or below the value of its underlying holdings.

When the market price is higher than the fund's NAV, the ETF is trading at a **premium**. When it is lower, the fund is trading at a **discount**.

Many ETFs publish their holdings daily, which may provide greater day-to-day transparency. However, knowing what an ETF owns does not automatically reveal whether it is appropriate for a particular investor.

Mutual Funds Are Priced Once Each Trading Day

The way mutual funds are priced can make them relatively straightforward for long-term investing.

An investor places an order, and the trade is completed at the fund's next calculated NAV. Everyone purchasing or redeeming the same share class at that time receives the same NAV.

There is no need to monitor intraday price movements or decide whether to submit a trade at a specific moment. This structure may work well in accounts built around scheduled contributions, automatic investments, or long-term retirement savings.

However, investors cannot lock in an intraday price. The final transaction value will not be known until the NAV is calculated after the market closes.

That limitation may matter when markets are moving sharply or when a portfolio requires more precise trade execution.

ETFs Trade Throughout the Day

ETFs offer greater intraday trading flexibility because their shares can be bought and sold whenever the relevant exchange is open.

This allows a portfolio manager to respond to changing market conditions without waiting for an end-of-day price. A limit order may also be used to establish the highest purchase price or lowest sale price considered acceptable.

That flexibility can be helpful, but it introduces additional considerations.

An ETF’s quoted market price may differ from its underlying NAV. The bid-ask spread, which is the difference between the highest price a buyer will offer and the lowest price a seller will accept, may also increase the effective cost of trading.

ETFs with lower trading volume or less-liquid holdings may have wider spreads. Market conditions can cause those spreads to widen further.

The ability to trade throughout the day is a feature, not a guarantee of better results. The value depends on how that flexibility is used within a disciplined strategy.

Active and Passive Management Can Apply to Both

It is common to associate mutual funds with active management and ETFs with passive index investing. That description is no longer complete.

Mutual funds and ETFs can both follow active or passive strategies.

An **actively managed fund** relies on a manager or investment team to select securities based on research, market expectations, risk analysis, or a specific investment philosophy.

A **passively managed fund** generally seeks to track an index or benchmark. Rather than selecting investments in an effort to outperform the market, it attempts to mirror the benchmark’s holdings and results before expenses.

Active management may provide flexibility and professional security selection. It may also involve higher expenses and greater differences from the broader market.

Passive funds may offer lower costs and broad market exposure. However, they still carry market risk and can decline when the index they follow falls.

We examine the actual strategy instead of relying solely on whether the investment is labeled a mutual fund or ETF. **The fund's structure and its management style are separate decisions.**

Comparing Mutual Fund and ETF Costs

Costs can have a lasting effect on investment results, especially when they continue year after year.

Both mutual funds and ETFs may charge an **expense ratio**, which represents the fund's annual operating expenses as a percentage of its assets.

Additional costs may include:

- Sales loads
- Redemption fees
- Account fees
- Brokerage commissions
- Bid-ask spreads
- Advisory fees
- Transaction expenses inside the fund

Some mutual funds have multiple share classes. Each class may hold the same portfolio but impose different fees, sales charges, or ongoing expenses.

ETFs are often associated with low expense ratios, particularly when they track broad indexes. However, not every ETF is inexpensive. Specialized, actively managed, leveraged, inverse, commodity-based, or narrowly focused ETFs may carry higher costs and additional risks.

FINRA notes that all mutual funds have fees and expenses, and its Fund Analyzer can compare the effects of fund costs over time. The tool also covers ETFs and other fund products.

We evaluate expenses as one part of a broader analysis. The lowest-cost fund is not necessarily the strongest fit if its holdings, risk, tax characteristics, or strategy fail to support the client's objectives.

Mutual Funds and ETFs May Have Different Tax Effects

Taxes are another area where fund structure can matter.

Mutual funds may distribute taxable capital gains when the fund manager sells securities at a profit. Investors holding shares in a taxable account may owe taxes on those distributions even if they did not sell their own fund shares.

This can be frustrating when an investor purchases a mutual fund shortly before a year-end capital gains distribution. The investor may receive a taxable distribution connected partly to gains earned before the investment was purchased.

ETFs often have structural features that may reduce the frequency of capital gains distributions. Their creation and redemption process can allow certain securities to leave the portfolio without requiring the fund to sell them in the open market.

However, ETFs are not automatically tax-free or universally more tax-efficient.

An ETF may distribute dividends, interest, or capital gains. Selling ETF shares at a profit may also produce a taxable gain. The tax effect depends on the fund's holdings, trading activity, structure, account type, and the investor's individual circumstances.

Tax considerations also differ between taxable brokerage accounts and tax-advantaged retirement accounts. We address fund selection as part of coordinated wealth management rather than treating taxes as an afterthought.

Diversification Depends on What the Fund Owns

Mutual funds and ETFs can both provide access to numerous securities through one investment. That may help diversify a portfolio, but the fund label alone does not guarantee meaningful diversification.

A broad-market fund may hold hundreds or thousands of companies. A narrowly focused fund may hold only a small group of businesses in one sector.

Even funds with many holdings may be heavily concentrated in their largest positions. Two funds with different names may also own many of the same securities, creating more overlap than the investor realizes.

We examine factors such as:

- Number of holdings
- Weight of the largest positions
- Industry concentration
- Geographic exposure
- Company size
- Bond maturity and credit quality
- Exposure shared with other funds
- Sensitivity to interest rates or market declines

Both mutual funds and ETFs carry risk, and neither previous returns nor the number of holdings can guarantee future performance.

Through risk management, we evaluate how each fund affects the complete portfolio rather than reviewing it in isolation.

Choosing Funds for Retirement Planning

Retirement changes the way mutual funds and ETFs should be evaluated because the portfolio may eventually need to generate dependable income.

Before retirement, a client may be focused primarily on growth and accumulation. As retirement approaches, the plan must increasingly address withdrawals, taxes, health care costs, inflation, and the possibility of a long lifespan.

A fund's liquidity, volatility, income, expenses, and tax characteristics may all affect its role.

For example, an investor may need:

- Growth-oriented funds to support long-term purchasing power
- Bond funds to help manage volatility and generate income
- Cash or short-term holdings for near-term withdrawals
- Tax-aware funds in taxable accounts
- A rebalancing strategy for changing market conditions

A portfolio that appears diversified during stable markets may behave differently during a significant downturn. We use retirement planning to align investments with expected income needs, retirement timing, and the client's ability to withstand market losses.

Special Considerations for University Professors

University professors often have retirement assets spread across several plans, institutions, and investment providers.

A professor may hold mutual funds or ETFs inside:

- A 403(b)
- A 401(a)
- A 457(b)
- An individual retirement account
- A taxable brokerage account
- A previous employer's retirement plan
- A spouse's workplace plan

Some university plans provide a limited menu of mutual funds. Other accounts may offer a broader mix of mutual funds, ETFs, annuity options, or self-directed investments.

The challenge is not merely selecting the fund with the strongest recent return. The holdings across every account must work together.

Through the professor retirement system, we help academic professionals coordinate institutional benefits, personal investments, income expectations, taxes, and retirement goals.

Mutual Funds and ETFs in Small-Business Retirement Plans

Employers must consider more than investment performance when selecting funds for a workplace retirement plan.

A suitable plan may require:

- A diversified investment menu
- Reasonable fees
- Clear employee communications
- Appropriate target-date or balanced options
- Ongoing investment reviews
- Documented fiduciary oversight
- Support for employees with different experience levels

Mutual funds remain common in workplace plans because they can support automatic payroll contributions and provide familiar investment choices.

ETFs may be available through certain plan structures, brokerage windows, or managed accounts. Their usefulness depends on the plan's platform, administrative design, participant needs, and fiduciary process.

Our small business retirement planning services help employers organize, implement, monitor, and understand retirement plans that support both the company and its employees.

Is an ETF Better Than a Mutual Fund?

An ETF is not automatically better than a mutual fund, and a mutual fund is not automatically better than an ETF.

A suitable choice depends on:

- The fund's underlying investments
- Investment objective
- Risk level
- Expense ratio
- Trading costs
- Tax implications
- Account type
- Liquidity
- Time horizon
- Role within the portfolio

An inexpensive, diversified mutual fund may be more appropriate than a complex ETF. A broadly diversified ETF may be more useful than a high-cost mutual fund. In other situations, neither fund may fit the strategy.

We focus on **how an investment supports the plan**, not which category is currently more popular.

Build a Portfolio With Purpose

Mutual funds and ETFs can both provide diversified access to stocks, bonds, and other investments. Their most visible difference is how they trade, but that's only the beginning.

Pricing, expenses, tax treatment, transparency, management style, liquidity, and risk can all influence the outcome.

At Intermountain Wealth Management, we help clients in Idaho Falls and throughout Eastern Idaho evaluate these choices within a coordinated financial strategy. We consider what each fund owns, why it belongs in the portfolio, how much it costs, and whether it continues to support the client's changing goals.

A thoughtful portfolio should be built around your life rather than a general debate about which fund structure is better.

Contact us for a free financial review and let's discuss whether your current investments are working together as effectively as they should.

Related Questions

Can mutual funds or ETFs invest in both stocks and bonds?

Yes. Balanced and allocation funds may hold stocks, bonds, cash, and other assets within one portfolio. The exact mix depends on the fund's stated investment strategy.

Do ETFs always require the purchase of a full share?

Not necessarily. Some brokerage platforms allow fractional ETF purchases, though availability and trading rules depend on the provider.

Can a mutual fund change its investment strategy?

A fund may modify its strategy, management, benchmark, or policies subject to applicable rules and shareholder disclosures. Investors should review updated fund documents when changes occur.

What happens if a mutual fund or ETF closes?

The fund may liquidate its holdings and distribute the proceeds to shareholders. A taxable account could experience tax consequences when the distribution occurs.