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What Is The Difference Between an ETF and a Managed Fund?

How to understand the difference in fund structures and pick the correct fund for you.

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If you've started investing, you've likely come across two of the most popular ways to grow your money: ETFs (exchange-traded funds) and managed funds (often called mutual funds). Both pool money from a series of investors to buy a diversified blend of assets, be it stocks, bonds, or alternatives, like cryptocurrency.

But they operate in distinct ways, which will impact your investing experience.

Understanding how these structures differ is crucial to building an efficient, tax-aware, and goal-oriented portfolio. Below, we'll break down how ETFs and managed funds compare across structure, fees, taxes, and investment suitability.

Structural and Operational Differences

At their core, both ETFs and managed funds aim to make diversified investing simple. The key difference lies in how they're built and traded.

ETFs trade on stock exchanges, just like individual stocks. Their prices fluctuate throughout the day based on supply and demand. Investors can buy or sell ETF shares at any time during market hours.

Most ETFs are passively managed, meaning they track a specific index (such as the S&P 500) rather than relying on fund managers to manually select securities. However, actively managed ETFs have become more popular, allowing professional managers to adjust holdings within the ETF structure based on their clients specific investment needs, such as a tax-efficient portfolio. Twin Oak's actively managed ETFs, for example, fall into this category.

Mutual funds, on the other hand, are bought directly from the fund company at the end of each trading day. They are priced once daily, based on the fund's net asset value (NAV).Managed funds are almost always actively managed, with professional portfolio managers choosing securities in an attempt to outperform the market. Because of this hands-on approach, their operational costs and investor fees tend to be higher.

Pros and Cons: Fees, Expense Ratios, and Cost Transparency

Fees are one of the biggest differentiators between ETFs and managed funds, and one of the most crucial to understand when evaluating your long-term returns.

ETFs are known for low expense ratios. Because most are passively managed, they don't require expensive research teams or constant trading.

Many ETFs that track an index charge less than 0.10% per year in management fees. ETFs also tend to be more transparent. They publish their holdings daily, and trading costs are visible in the market.

Mutual funds often charge higher expense ratios, typically ranging from 0.50% to 1.5% annually. These fees compensate portfolio managers and analysts who actively pick investments.Some managed funds also impose commissions, which can further reduce returns.

ETFs offer real-time visibility into trading costs and holdings, while mutual funds provide disclosures quarterly or semi-annually. For investors who value cost clarity and control, ETFs often have the edge.

Tax Implications

Tax efficiency is another major area where ETFs and managed funds diverge, especially for investors holding assets in taxable accounts.

ETFs are generally more tax-efficient thanks to their "in-kind" creation and redemption process. When investors buy or sell ETF shares, the transactions occur between investors on an exchange, and when institutional investors redeem shares, ETFs can deliver underlying securities "in kind" rather than selling them. This structure allows ETFs to avoid triggering capital gains taxes for remaining shareholders. Investors typically owe taxes only when they sell their own ETF shares.

Mutual funds, by contrast, must sell securities when rebalancing, or to meet redemptions when investors cash out. These sales often generate capital gains distributions, or taxable events passed on to all fund shareholders, even those who didn't sell their shares.

When Does One Make More Sense Than the Other?

Choosing an ETF or a mutual fund often depends on your investment goals and account type.

- **Long-Term Passive Investors:** ETFs typically make more sense for buy-and-hold investors seeking low-cost, diversified exposure. A simple portfolio of index ETFs can form the foundation of a retirement or taxable investment strategy.
- **Active Investors or Retirement Plans:** Managed funds can be suitable for investors who prefer professional oversight or want to access strategies unavailable in ETF form. They're also common in employer-sponsored plans, where fund access and fees are often negotiated. But active management in ETFs is also becoming more common.

- **High-Net-Worth Investors and Family Offices:** ETFs tend to outperform mutual funds on an after-tax, after-fee basis, which is crucial for investors with a large amount of capital invested in a taxable brokerage account.

Which One Is Right For You?

Both ETFs and managed funds can play valuable roles in a diversified investment strategy. ETFs offer low-cost, tax-efficient, and transparent access to the markets, which is ideal for hands-off, long-term investors. Managed funds, meanwhile, provide active management and structure suited to automated or institutional settings.

The key is to understand how each works, what you're paying for, and how it fits within your broader financial goals. Whether you prefer the simplicity of index ETFs or the hands-on approach of an actively managed fund, the best choice is the one that aligns with your investment plans and long-term outlook.

Definitions (as used by Twin Oak):

1. **Cost-effective ETFs:** As defined compared to hedge funds, which commonly charge a 2% management fee as well as 20% of the profits.
2. **Institutional Grade:** Investment strategies generally only accessible in private fund formats to accredited investors.
3. **Tax Alpha:** The amount of a gross return lost to the tax drag of an investment vehicle through realized taxable events.
4. **Low Cost:** Defined on a case-by-case basis but generally refers to solutions that are cheaper than private funds (2% management fees and 20% carry).

An investor should consider the investment objectives, risks, charges, and expenses of the Fund(s) carefully before investing. The prospectus and the summary prospectus contain this and other information about the Fund(s). You may obtain a prospectus and a summary prospectus by visiting twinoaketfs.com. Please read the prospectus or summary prospectus carefully before investing.

All investments are subject to risks, including the possible loss of principal. There is no assurance that the objectives of any strategy or fund will be achieved or will be successful. PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS; there is no guarantee that Twin Oak will be able to successfully implement the strategy.

1. **New fund risk:** The Fund is a newly organized, management investment company with no operating history.
2. **Non-diversification risk:** More of the Fund's assets may be invested in the securities of a single issuer than could be invested in the securities of a single issuer by a diversified investment company. This may make the value of the Shares more susceptible to certain risks than shares of a diversified investment company. The Fund has a greater potential to realize losses upon the occurrence of adverse events affecting a particular issuer.
3. **Counterparty Risk:** Some of the Fund's derivatives contracts are privately negotiated in the over-the-counter market. A counterparty defaulting on its payment obligations to the Fund will cause the value of an investment in the Fund to decrease.
4. **Derivatives Risk:** The Fund may use derivative contracts which can disproportionately increase losses and reduce opportunities for gains when stock prices, currency rates, or interest rates are changing.
5. **Illiquid Securities Risk:** The Fund may invest up to 15% of its net assets in illiquid investments which are instruments that the Fund reasonably expects cannot be sold or disposed of in current market conditions within 7 calendar days or less without the sale or disposition significantly changing the market value of the investment.
6. **Leverage Risk:** The Funds use of options, swaps, or other derivative instruments may result in losses to the Fund or may adversely affect the Fund's NAV or total return, because these instruments are more sensitive to interest rate changes.
7. **Options Risk:** Purchasing and writing put and call options are highly specialized activities and entail greater than ordinary investment risks from which the Fund may not fully benefit.
8. **New advisory risk:** This is a newly registered investment advisory and as a result, there is no long-term track record against which an investor may judge the Adviser, and it is possible the Adviser may not achieve the Fund's intended investment objective.

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