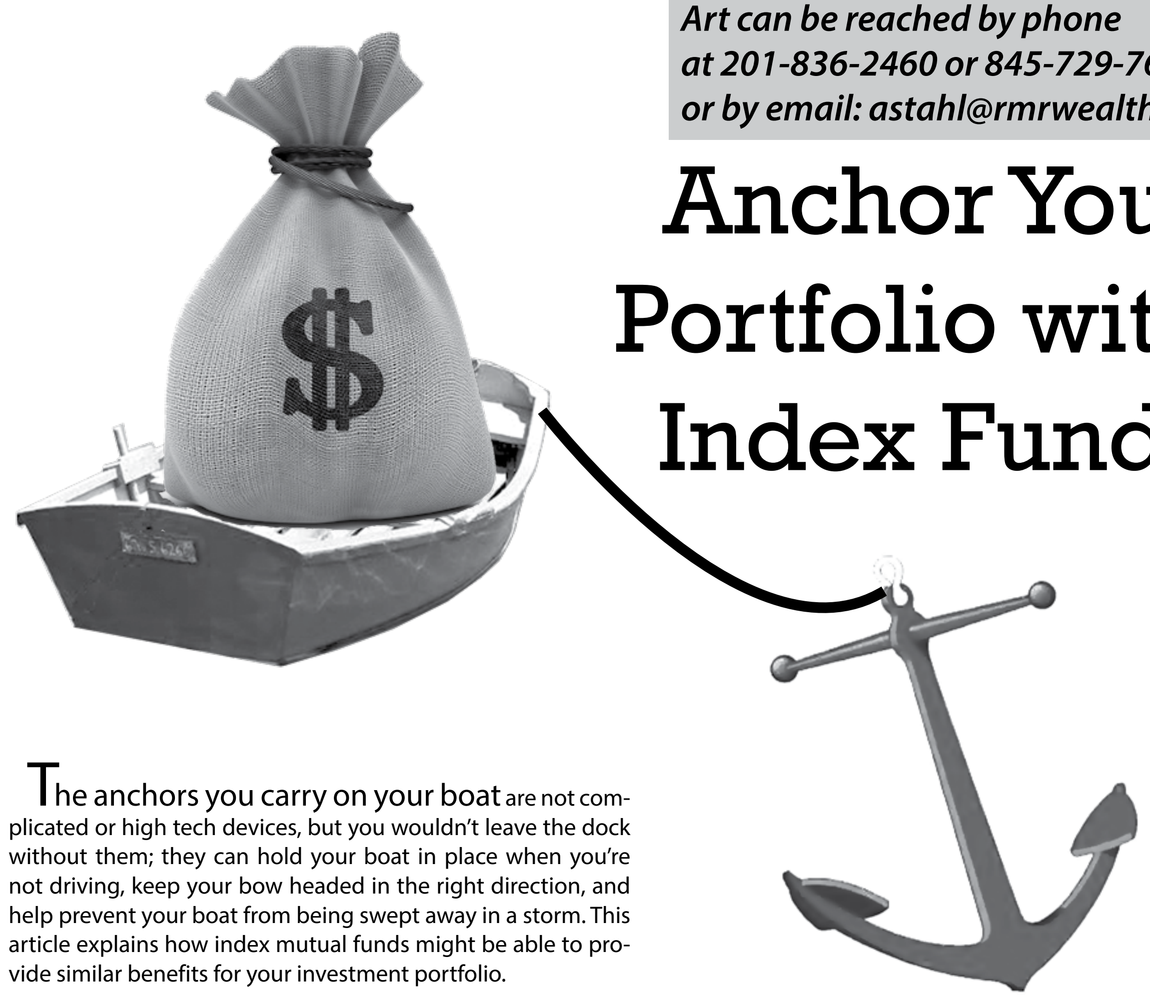
Your Finances

Article provided by Art Stahl

Art can be reached by phone at 201-836-2460 or 845-729-7638, or by email: astahl@rmrwealth.com

Anchor Your Portfolio with Index Funds



The anchors you carry on your boat are not complicated or high tech devices, but you wouldn't leave the dock without them; they can hold your boat in place when you're not driving, keep your bow headed in the right direction, and help prevent your boat from being swept away in a storm. This article explains how index mutual funds might be able to provide similar benefits for your investment portfolio.

One of the most basic distinctions among mutual funds is whether the fund manager employs an active or a passive management approach. An active management style means the fund manager uses analytic or forecasting tools to select individual stocks for the fund portfolio. In a passive approach, the fund manager simply buys whatever stocks are represented by a well-known market index. Funds that attempt to match exactly the day-to-day fluctuations of a market index are index funds.

What Are Index Funds?

By investing in an index fund that mimics the S&P 500 stock index, for example, an investor could achieve some measure of diversification in 500 widely held stocks traded on the New York Stock Exchange, the American Stock Exchange, and Nasdaq.1

Index funds purchase or sell shares of stocks only when the index replaces stocks or when investors buy or sell shares of the fund. Unlike actively managed funds, index funds do not attempt to buy stocks based on the fund manager's outlook for certain companies or for the market in general.

The passive approach of index funds generally means the expense ratio of index funds is substantially lower than that of actively managed stock funds. The average expense ratio of index funds was 0.75% in 2011, compared with 1.24% for actively managed funds.2 The higher management expenses of actively managed funds make it more difficult for them to outperform index funds on a consistent basis. Management fees and expenses are deducted from a fund's results in the calculation of returns.

Using Index Funds Within a Portfolio

Asset allocation and diversification may require buying more than one index fund.3 The 500 companies within the S&P 500 index, for example, constitute only a portion of the U.S. stock market and represent only large-capitalization stocks. The Russell 2000 small-cap index, the S&P 400 Mid Cap index (an unmanaged index of 400 stocks generally considered representative of the U.S. midcap market), and the Morgan Stanley Europe, Australasia, and Far East index (EAFE) are among the most widely quoted indexes; there are many index funds that track these.4 The variety of index funds available allows investors to diversify into a wide array of stocks by indexing according to investment goals and risk tolerance.

Index Funds Versus Actively Managed Funds

Index Funds

- Stocks are selected to mirror the underlying index.
- Risk level matches that of the index.
- Fees and expenses are typically lower due to infrequent trading and limited research needs.
- Performance is typically slightly below that of the underlying index.

Actively Managed Funds

- Stocks are selected based on investment objectives.
- Risk and return may vary.
- Investors pay higher fees and expenses.
- There is potential for above-market performance.

Source/Disclaimer:
Employee Benefit Research Institute and Greenwald & Associates, 2016 Retirement Confidence Survey, March 2016.
Because of the possibility of human or mechanical error by Wealth Management Systems Inc. or its sources, neither Wealth Management Systems Inc. nor its sources guarantees the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. In no event shall Wealth Management Systems Inc. be liable for any indirect, special or consequential damages in connection with subscriber's or others' use of the content.

This article is provided by the Financial Planning Association, a membership organization for the financial planning community, and is brought to you by Art Stahl, a Past Commodore of the Nyack Boat Club and a member of the Greater Hudson Valley Chapter of the FPA. Art is a Financial Advisor with RMR Wealth Builders, Inc., 500 Glenpointe Centre West, Teaneck, NJ 07766. Securities and investment advisory services offered through Calton & Associates, Inc., member FINRA/SIPC. RMR Wealth Builders, Inc., and Calton & Associates, Inc. are separate entities.