Mutual Funds Vs. Index Funds: Which should you pick?

In this day and age everyone is investing. Younger and younger, these new generations have found the spark to invest their money and have their money work for them much earlier than their predecessors. When considering investments, one of the most popular and recognizable options are stocks. Stocks are shares of companies that are divided to the public and represent partial ownership in the company. When buying a stock, investors actively are buying portions of a singular company which can entail quite a lot of risk. This is where funds come into play. Funds typically invest into multiple different stocks which makes them inherently less risky and more applicable to the average investor. When investors are considering investing in funds, there are typically two major options that they can invest into- mutual funds or index funds.

Mutual Funds are managed funds that collect the money from shareholders to invest into stocks. Mutual funds are managed which is a key feature of these types of funds. These funds are often managed by professional money managers that choose the different stocks and holdings that the funds will possess. The fact that these funds are often actively managed makes them hold higher fees and additional costs when compared to their counterpart.

Index funds are funds that are a pool of investments that aim to mimic an index. These funds are following indexes like the Standard and Poor's 500, Dow Jones Industrial Average, NASDAQ, and other popular indexes. Index funds typically will be less risky overall because of the fact that it is simply mimicking an index, as opposed to having people actively choose what goes into the fund. The fact that Mutual Funds are actively managed makes for higher fees, but also usually reaping higher returns. Index funds are typically going to be recommended for beginners and new investors who have less experience in the stock market and in the investing scene.

When making the choice of whether you should put your money into a mutual fund or index fund, it is important to understand your goals clearly and your risk tolerance. Mutual funds are typically going to require more research because they are being actively managed by professionals, and it is important to see their track record and whether or not they historically have beaten the market. Index funds are typically going to give you average market returns, which are steady and reliable in most cases, and mutual funds will attempt to beat out the average returns of the market, which can sometimes be more risky. Mutual funds can also be specified down more into classifications like sector funds, which focus on one sector of stocks, like technology or healthcare. Choosing different sector funds can help you diversify your portfolio and invest in many different sectors, rather than a mesh of all of them. If the technology sector is doing better than average in a given year, you will make better returns on this specific sector fund than your other funds, which will likely be performing along with typical market trends. When holding sector funds you can usually receive higher rates of return, but you can also have higher risk because certain sectors can always go the opposite way as well.

In short, mutual funds and index funds can both be very beneficial and help with getting into investing because they are seen as much less risk aversive than individual stocks. These kinds of investments do not cause stress to new investors worrying about the market day to day or week to week and instead offers a new source of steady income and ultimately help individuals reach financial freedom and their own financial goals.