

The magic of index funds

You want to invest on your own, but you don't want to pick stocks or mutual funds.

Index funds may be your cup of tea — if you like your tea not too hot or too cold, but just right. They're designed to keep pace with a specific market, sector or investment category.

Index funds won't fall behind the benchmarks. Neither will they rise above.

To be successful at indexing, you give up on the idea of being an investing superstar. You make two resolutions:

- I won't keep searching for the right stocks or funds that will beat the market on a consistent basis.
- I won't aim for above-average returns, but neither will I settle for below-average returns. I'll be happy with average returns.

John Bogle, the founder of Vanguard Funds, created the world's first index fund in 1974. Now in his late 70s, he's still writing and speaking about his favourite strategy.

"His proselytizing has been successful," says Canadian author Gordon Pape about Bogle's *The Little Book of Common Sense Investing*.

"Indexing has become an incredibly popular way to invest, and exchange-traded funds (ETFs), indexed securities that trade on stock markets, are growing at a prodigious rate."

If you try your hand at indexing, you can buy index funds or exchange-traded funds — or use both



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products. Here's the difference:

An index fund is set up as a mutual fund trust. It has an unlimited number of units and is not traded on a stock exchange. The net asset value is calculated only once a day.

An exchange-traded fund tracks an index the same way as does a mutual fund. But it trades like a stock on an exchange. An ETF's price can change throughout the day as it's bought and sold. You can buy it on margin and sell short.

The advantage of ETFs is cost. Less cumbersome to manage than mutual funds, they have a lower management-expense ratio, or MER.

The popular iShares CDN Large Cap 60 Index Fund (ticker symbol XIU) has an MER of just 0.17 per cent. Started in 1999, it tracks the S&P/TSX 60 index.

But if you want to invest in exchange-traded funds, you must have a brokerage account. And you must pay commissions each time you buy and sell. The commissions may be as low as \$5 to \$10 for discount brokerage investors who have a high level of assets or trade frequently.

Other investors will pay \$25 to \$30 each time they trade with a discount broker and up to 2 per cent of the value of the trade with a full-service broker.

The advantage of index funds is access and simplicity. You can buy them from your local bank branch — or order by phone or online — without opening a brokerage account.

Banks sell index funds on a no-load basis. This means there are no commissions to buy and sell. Index funds are more cost-effective than ETFs if you buy small amounts on a regular basis.

You can invest \$50 or \$100 weekly, biweekly or monthly to take advantage of the market's swings without worrying about sales charges eating into your capital.

Rebalancing is cheaper with index funds, too. This involves selling your winners when their value grows to the point that they're not in line with your original allocation.

No matter whether you use ETFs or mutual funds, you can still put together an easy-care, no-muss-no-fuss portfolio that covers all the bases.

• Next week: The building blocks of a "couch potato" or "easy chair" portfolio.

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