Difference Between Stocks and Mutual Funds

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Key Difference - Stocks vs Mutual Funds

The key difference between stocks and mutual funds is that **stocks are units that represent the ownership of the company** whereas **mutual funds are professionally managed investments, made up of a pool of funds collected from many investors who share similar investment goals.** Stocks and mutual funds have experienced immense growth year over year as investment options; the total value of stocks trading on major stock exchanges in the world has exceeded $1 trillion and the total value of mutual funds was estimated to exceed $265 million in 2013.

What are Stocks?

Also known as **shares** or **ordinary shares**, stocks are units that represent the ownership of the company. Dividends and capital gains (appreciation of share price) are benefits enjoyed by investors when stocks are purchased.

Stocks are traded (bought and sold) via a stock exchange. To be able to trade a security on a stock exchange, it must be listed on that specific stock exchange. One stock can be listed on more than one exchange as well, which called **dual listing**. Two forms are available in stock exchanges as primary market and secondary market. When the shares or bonds are first offered to the pool of general investors, they will be trading in the primary market and the subsequent trading will happen in the secondary market.

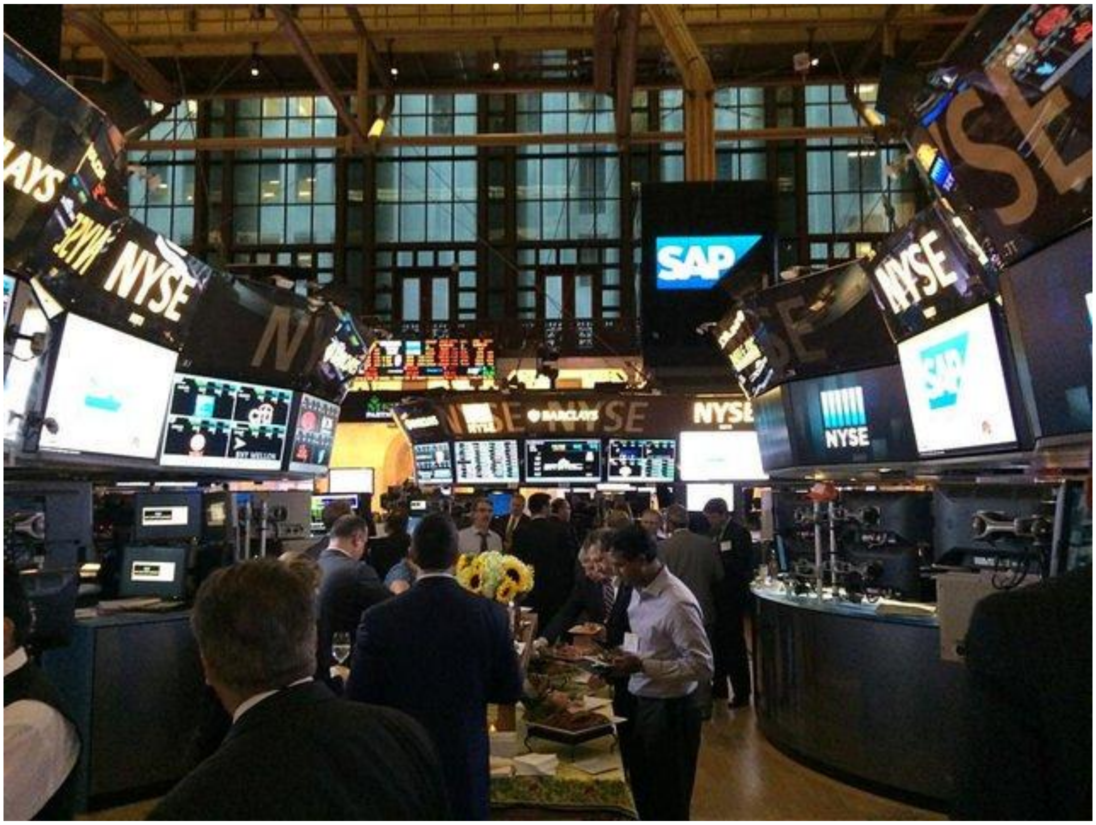

Figure 01: New York Stock Exchange (NYSE) is the world's largest stock exchange.

Stocks are available in two major categories: equity stocks and preference stocks.

Equity Stocks

Equity stockholders are entitled to voting rights of the company. Maintaining voting rights exclusive to equity stockholders allow them to avoid other parties getting involved in major decisions such as mergers and acquisitions and election of board members. Each stock unit carries one vote. However, in some situations, certain companies may issue a portion of non-voting equity stock as well.

Equity shareholders also receive dividends at a fluctuating rate since the dividends will be paid after preference shareholders. In a situation of company liquidation, all the outstanding creditors and preference shareholders will be paid off before equity stockholders. Thus, equity stocks carry higher risk in comparison with preference stocks.

Preference Stocks

Preference stocks are often classified as hybrid securities since dividends can be paid at a fixed or a floating rate. These shares do not have the authority of voting in company matters, however, receives dividends at a guaranteed rate. Further in a situation of liquidation preference shareholders are paid off prior to equity shareholders, thus the risk carried by these are relatively low. Often preference stockholders are considered as lenders of capital to the company than actual owners. There are different types of Preference stocks,

Cumulative Preference Stocks

Preference stockholders often receive cash dividends. If a dividend is not paid in one financial year due to lower profits then the dividend will be accumulated and is payable to the shareholders at a later date.

Noncumulative Preference Stocks

This type of preference stocks does not carry the opportunity to claim dividend payments at a later date.

Convertible Preference Stocks

These preference stocks come with the option to be converted to a number of ordinary shares at a pre-agreed date.

What are Mutual Funds?

Mutual funds are professionally managed investments made up of a pool of funds collected from many investors who share similar investment goals. The collected funds are invested in a number of securities such as stocks, bonds, and money market instruments. A mutual fund's investment portfolio is managed as stated in its prospectus (a legal document that specifies all relevant information to investors including investment goals). A mutual fund is managed by a fund manager, who is a financial professional who takes investment decisions of the fund. Various types of fees should be paid in the process of investing in a mutual fund.

Purchase Fee

This is the fee charged up front by investors when acquiring shares.

Redemption Fee

Redemption Fee is charged in certain mutual funds when investors sell their shares.

Performance Fee

Performance fee is payable to the fund manager when the fund generates positive results.

Investors can purchase units of mutual funds (also referred to as mutual fund shares), which is similar to ordinary shares. However, unlike in shares, the trading does not occur through an exchange and the units are purchased directly from the fund. Shares are redeemable and can be sold back to the fund any time the shareholder wish. Price per share of a fund is named as the **Net Asset Value (NAV)**. Similar to stocks, dividends and capital gains are also receivable by shareholders in a mutual fund.

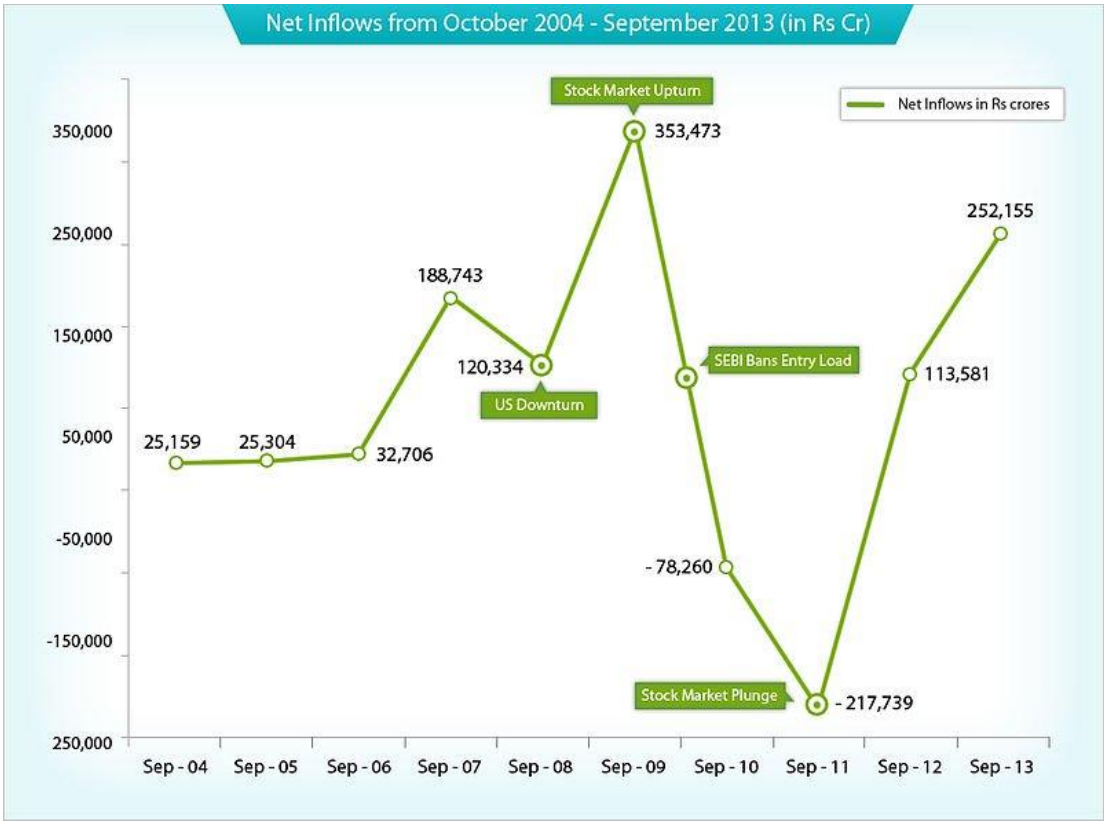

Figure 02: Mutual Fund sales growth from 2004-2013.

What are the similarities between Stocks and Mutual Funds?

- Both stocks and mutual funds pay dividends and lead to capital gains

What is the difference between Stocks and Mutual Funds?

Stocks vs Mutual Funds	
Stocks are units that represent the ownership of the company.	Mutual funds are professionally managed investments made up of a pool of funds collected from many investors with similar investment goals.
Value	
The value of stock is the stock price.	NAV represents the value of a mutual fund.
Purchase an Sale	
Purchase and sale of stocks is done through an exchange.	Shares are directly purchased from the fund and can be sold back to the fund.
Performance Fee	

There is no performance fee in stocks	Performance fee is paid to the fund manager in a mutual fund for generating favorable results

Summary - Stocks vs Mutual Funds

The difference between stocks and mutual funds is mainly attributable to the nature of each. While stocks of a listed entity can be traded through an exchange, a mutual fund is a separate unit managed by a fund manager. A number of investors who share similar investment goals come together in a mutual fund while investing stocks is an individual activity. Nevertheless, the overall objectives of both are similar in nature since they contribute to the appreciation of the wealth of the investor.

Image Courtesy:

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2. "Mutual Fund sales growth from 2004 to 2013" By QuantumMF - Own work, CC BY-SA 3.0) via Commons Wikimedia

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