FinStart

How do you make money when you invest in mutual funds?

I. From fund distributions

- Stocks / bonds in your mutual fund pay dividends / interest.
  - This only matters when you have a taxable account (and only for dividends from Canadian companies – because they are taxed lower than other dividends and than all interest).
- Funds package this money into periodic distributions.
- Management fees (like the MER) are subtracted - what's left is deposited into your account periodically.

II. From capital gains

When you sell some units of your mutual fund for a higher price than you bought them for, you earn the difference - as capital gain. When you sell for less than you bought for, you suffer capital loss. If your capital gains exceed your loses, you profit.

Something you should know

You may see paper capital gains / losses in your account when your mutual fund sells securities / other funds it owns, even if you didn't personally sell anything.

- 'Paper' means that you don't actually get money - it's an accounting item. But it's still subject to income tax that year.

This won't matter if your account is registered - TFSA / RRSP / RESP.

But if you're opening a taxable account, investment strategies using (like a robo-advisor ETF portfolio, an asset-allocation ETF, or your own portfolio of ETFs / GICs) ETFs may be a better choice than mutual funds.

- This is because index ETFs, compared to mutual funds, usually do not have high paper capital gains. They are built differently than mutual funds. When mutual fund investors want to sell, mutual funds need to sell some securities they own. This creates capital gains / losses. When ETF investors want to sell, they trade their shares on the stock exchange – and on normal trading days the ETF most likely does not have to sell any securities at all.