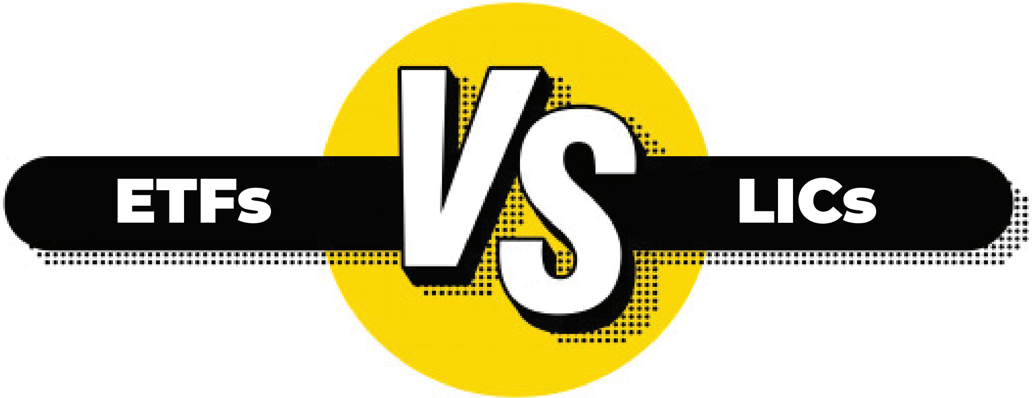

ETFs versus LICs - which is best for my portfolio?

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Exchange traded funds (ETFs) and listed investment companies (LICs) are both popular investment options within Australia. Although they share a number of similarities, there are also important differences to consider as an investor.

We'll look at some of the main differences between the pair to help you decide which is best for your portfolio.

What is an ETF?

An ETF is a type of investment fund that trades on a stock exchange – similarly to regular shares. ETFs invest in a basket of assets, such as stocks, commodities and bonds.

ETFs will often track a particular market index such as the S&P/ASX 200. Rather than trying to outperform this index, these "passive" ETFs aim to closely mimic the index performance. This means your returns will rise and fall in line with the tracked index.

What is a LIC?

A LIC is a publicly listed company (hence the name, listed investment company) that operates like a managed fund. Like an ETF, LICs may invest in a variety of assets, including stocks, property and bonds. The main similarity is that both ETFs and LICs allow you to invest in a diversified portfolio. This may include a single asset class, such as stocks or bonds, or it could hold multiple assets.

You also invest in a LIC in much the same way as an ETF – over a stock exchange. Unlike ETFs, LICs issue a fixed number of shares that investors can buy or sell on the stock market (usually the ASX). This means that the price of a LIC is partly determined by demand from investors and may not always be liquid. In some scenarios, an investor might be forced to sell their LIC shares at an undesirable price if there aren't enough buyers in the market.

On the other hand, ETFs are known as 'open-ended' investments, meaning the number of ETF units in circulation is not fixed. Instead, units can be issued and removed based on demand. This means that supply and demand has less of an impact on ETF prices than the underlying portfolio itself.

What are the main differences between ETFs and LICs?

Structure

A LIC is structured as a company, so if you decide to invest in a LIC, you'll own shares in the LIC itself, rather than the underlying assets. An ETF, on the other hand, is a unit trust, which means you'll receive units in the fund if you decide to invest.

Strategy

ETFs typically offer exposure to an entire market, region or market sector such as global health or technology stocks. They have the potential to track hundreds or even thousands of stocks. Although not always the case, most ETFs are passive investment products, meaning they either track an index or use filters to decide which stocks are included in the fund. LICs, on the other hand, actively select each individual asset to invest in. The LIC will have an investment team responsible for choosing and managing the company's investments.

Tax obligations

Because an ETF is a unit trust, all tax obligations are passed on to investors. Any dividends and franking credits are passed directly to unitholders.

With a LIC, all dividends are paid to the company and it's at the discretion of management whether to pass on that income or reinvest the money back into the fund. If the LIC receives unfranked dividends from the underlying investments, it will typically pay tax on those dividends at the company tax rate and deliver franked dividends to shareholders.

Cost

ETFs are relatively cheap because they aim to track an index rather than outperform it. LICs tend to cost more because they have investment managers deciding which assets to invest in. If the manager outperforms the benchmark, this may result in additional fees.

Both ETFs and LICs are an affordable way to invest in a wide asset pool. Management fees are generally lower than traditional managed funds (although these can differ depending on whether the fund is passively or actively managed). Both investment options offer high liquidity and provide access to a diverse range of assets in a single trade.

Purchasing ETFs or LICs – or both – can be advantageous, but it's important to understand how your money will be invested beforehand.

One of the biggest factors for most investors is how aligned prices are with the underlying assets, i.e. the net asset value (NAV). Because ETFs have an open-ended structure, the price of the ETF will trade very closely to the NAV. So if the value of the stocks held by the ETF rise, the price of the ETF will rise with it.

This is not always the case with LICs. They may trade at a premium (above) or discount (below) NAV, depending on how many buyers and sellers are trading LIC shares. So if stocks held by the LIC go up, but investors still aren't willing to buy, its share price may not rise.

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