



ETF FOCUS

## Buffett gives nod to index funds over ETFs

'Nobody encouraging you to trade it next week,' legendary investor says

By [John Spence](#), MarketWatch

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**BOSTON (MarketWatch) --** The world's most celebrated investor has nothing against exchange-traded funds, but given a choice he recommended sticking to plain-vanilla and low-cost index mutual funds because the temptation to engage in potentially self-destructive trading isn't as great.

Appearing Monday morning on CNBC from Berkshire Hathaway's ([BRKA](#)) ([BRKB](#)) annual shareholder meeting in Omaha, Neb., Chairman Warren Buffett reiterated his view that for most small investors who don't have time to research individual companies, cheap index funds are the best way to invest in the stock market.

"The best way in my view is to just buy a low-cost index fund and keep buying it regularly over time, because you'll be buying into a wonderful industry, which in effect is all of American industry," Buffett told CNBC anchor Liz Claman.

"If you buy it over time, you won't buy at the bottom, but you won't buy it all at the top either," the billionaire investor said.

In contrast to mutual funds run by portfolio managers actively picking stocks, broad-based index funds attempt to deliver market performance by tracking popular benchmarks such as the S&P 500 ([SPX](#)). This straightforward approach generally allows index funds to charge lower fees than actively managed funds.

"If you have 2% a year of your funds being eaten up by fees you're going to have a hard time matching an index fund in my view," Buffett said. "People ought to sit back and relax and keep accumulating over time."

He also weighed in on the debate surrounding traditional index funds and their newer cousins, ETFs, which are baskets of securities that trade on exchanges and are bought and sold like individual stocks. ETFs also track indexes, but unlike index funds they can be bought and sold throughout the trading day. Mutual funds, on the other hand, are priced once a day at the market close.

"I have nothing against ETFs, but I really think an index fund that just charges a few basis points for management is pretty hard to beat," Buffett said. "You put it away, you have nobody encouraging you to trade it next week or next month ... your broker isn't going to be on you."

Numerous academic studies have shown that individual investors have a bad track record at timing stock-market moves, often because they chase recent performance to their detriment, essentially buying high and selling low.



Another renowned investor, Vanguard Group founder John Bogle, in television appearances and articles also has expressed reservations about ETFs because they're easy to trade. Bogle, who stepped down as Vanguard's chief executive in 1996, is credited with popularizing index funds with retail investors.

Vanguard is best known for its low-cost index funds, but the company also has made a somewhat controversial entry into the booming ETF business.

In a Feb. 9 commentary piece printed in The Wall Street Journal, Bogle questioned the need to trade the S&P 500 all day long in real time though an ETF. (Dow Jones & Co. owns The Wall Street Journal as well as MarketWatch, publisher of this report.)

"If long-term investing was the paradigm for the classic index fund, trading ETFs can only be described as short-term speculation," he wrote. He also criticized ETFs' movement to narrower market segments and warned that brokerage commissions and taxes can ratchet up investors' overall fees when they trade ETFs a lot.

Yet in fairness to ETFs, Bogle said that if they are not traded, they can often match regular index funds. "In this format, used in that way, ETFs are solid competitors to their classic forebears," he wrote.

The tax advantages and low fees of ETFs are often touted, but a report Monday said they often end up underperforming similar index funds from Vanguard and Fidelity Group. [See Wall Street Journal story \(subscription required\).](#)

At the end of March there was \$444.26 billion invested in U.S.-listed ETFs, up about 35% from a year earlier, according to Investment Company Institute. ■

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