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Eight Benefits to Owning Individual Stocks over Mutual Funds

In this market, with historically low interest rates, owning stocks should be a critical part of anyone's portfolio. Yet, while the need for stocks is high, the last several years have made many investors frightened and leery of the volatility inherent with stock ownership. Much of this is due to people owning stocks through mutual funds and ETFs where investors have no real way to evaluate what they own, but suffer through extreme ups and downs, not able to understand what is happening. Owning individual stocks offers many benefits to investors.

Ability to Analyze – With some understanding of accounting and finance and a willingness to do the work, a company can be analyzed on a quantitative and a qualitative basis. As an investor, you can study the company's financial statements, analyze past sales and earnings information and make informed decisions on the company's future prospects. After the analysis is complete, a much more informed decision can be made on whether to buy, sell, hold or move on to the next company.

Know What you Own – When you own individual stocks you know what you own everyday. If you own a fund, you get a report every three months that shows you holdings at each quarter-end, which can often contain holdings that were just purchased because the managers want you to think they held those stocks over the entire quarter. And poorly performing positions can be sold right before quarter-end to hide those holdings. With individual stocks, you always know what you have and how it has performed. It is a much more transparent system.

Dividends – As a shareholder, you are entitled to any dividends the company pays, representing your share of the company's cash flow. Over the past 50-years, dividends have accounted for roughly half of the total return on stocks. When you own individual companies, you know every three months you're going to receive a cash payment. Additionally, many good dividend paying stocks increase their payout every year, so the yield on the original cost of your investment increases over time. Many mutual funds do pay dividends, but the exact rate every period isn't known and the default option is to simply buy more shares of the funds, not actually create income for the holders. With the 10-year US Treasury yielding a paltry 2%, many strong, blue-chip companies are paying dividend yields in the 3-5% range. Dividends are especially important for investors needing income.

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Easier to Understand Volatility – Stock prices will always go up and down and the market will invariably overreact at some point to good or bad news. When you own individual stocks and are familiar with the company, you can make a rational decision (since you've done the analysis already) to buy more shares, sell some shares or continue holding your existing position. If you own stocks through a mutual fund or an ETF, there is no ability to analyze any specific holdings or determine how to proceed. In many respects, you're just floating in the wind riding the ups and downs of the market. Owning individual stocks makes stomaching the volatility more tolerable.

Easier to Express a View – Every sector has outperformers and underperformers. If you buy a mutual fund focused on the energy sector, you agree to own most of the companies in that space. If, however, you analyze the companies and decide which specific firms are poised to outperform the competitors, then you can chose to purchase those stocks. You might not be right on every purchase, but if you're doing the research, you should be right on enough to come out ahead of a broad fund.

Lower Cost than Funds – Owning individual stocks is cheaper than owning mutual funds. The average managed mutual fund charges close to 1.5% per year – but owning Exxon-Mobil or Philip Morris International has no cost. At a time of lower than historical average returns, lower costs means higher returns. You also don't pay capital gains tax until you sell if you own individual stocks. With a mutual fund, in a taxable account, every year you pay taxes on your pro rata share of capital gains the fund generated over the course of the year.

Diversify your Holdings - Diversification is still important and I would never recommend a single company stock representing a significant portion of your total portfolio; however, appropriate diversification can be achieved by holding 15-25 individual positions across multiple sectors.

Support your Companies – Be an active supporter and marketer of your company's products. As an owner of Coca-Cola, I always choose to buy Coke products because I know, however small, that ultimately benefits my portfolio. I enjoy writing that check to Verizon every month knowing I'm helping to fund my 5%+ dividend. Owning individual stocks gives you the ability to help and support the companies you own.