

## Considerations Involving Mutual Funds, Exchange-Traded Funds and Money Market Funds

Many investors rely on mutual funds, exchange-traded funds (“ETFs”) and money market funds to pursue their financial goals. These products offer investors the ability to invest in diversified pools of securities that follow a variety of investment strategies with exposure to various types of asset classes. Despite these similarities, it is important for you to understand the differences between these products with respect to: (1) pricing and liquidity risk, (2) their fees and expenses, and (3) tax efficiency. The following information pertains to domestic mutual funds, ETFs and money market funds.

### **Pricing and Liquidity Risk**

#### *Mutual Funds*

Purchases and redemptions of mutual funds are priced in accordance with the net asset value (“NAV”) of a fund. A fund’s NAV is calculated by: (1) taking a fund’s assets, which include the fund’s securities and cash, (2) reducing that sum by the fund’s liabilities, which include its fees and expenses, and then (3) dividing that sum by the number of shares outstanding. This means that a mutual fund is valued by reference to its actual investments.

Most mutual funds determine their NAV at the end of each trading day, which is typically 4:00 p.m. ET. As a result, if you place a purchase or redemption order for a mutual fund at 10:00 a.m. ET, you will not know the final terms of your transaction until after the end of the trading day, when a final value for each of the fund’s underlying assets is ascertained. In this way, although mutual funds generally require investors to wait until 4:00 p.m. ET for final trade values, those values are derived from the actual investments held by the fund.

Shareholders in mutual funds may redeem their investments on any business day. Although many mutual funds pay out redemptions within a few business days, investors should be aware that mutual funds may have up to seven days to fulfill redemption requests. If a mutual fund cannot fulfill its redemption requests, it must seek permission from the Securities and Exchange Commission (the “SEC”) to suspend redemptions, which would likely lead to the liquidation of the fund. Although this has not occurred often, it underscores that mutual funds are not guaranteed investments and can lose money.

It is important to keep in mind that a number of factors play a role in a mutual fund’s ability to provide liquidity to shareholders, including a fund’s investment strategy. For example, mutual funds that invest in less liquid or harder-to-price securities, such as fixed income (particularly high yield, bank loan, or other less liquid credit segments), emerging or frontier markets, small cap equities, commodities, cryptocurrency or alternative strategies such as private equity and private credit, among others, are likely to be more susceptible to liquidity concerns, particularly during times of market stress.

Also, please keep in mind that when investors redeem mutual fund shares, funds generally pay redemption proceeds in cash. Many funds reserve the right, however, to pay redemption proceeds by giving investors actual portfolio securities in lieu of cash. This is generally referred to as a redemption in-kind. If this occurs, you will likely have to pay transaction costs, such as brokerage commissions, to sell those securities. You will also bear the risks of owning the securities, which include the possibility that the price of the securities will decrease while you hold them. Lastly, please note that redemptions in-kind from mutual funds are generally taxed in the same manner as redemptions paid in cash and that sales of such securities may generate taxable gains.

## *ETFs*

Purchases and redemptions of ETFs, on the other hand, are priced differently. Shares of ETFs are bought and sold on the secondary market (e.g., on stock exchanges), which means that investors do not transact with funds at prices based on NAV. Rather, the price of an ETF share is determined by the market—i.e., the price the buyer and seller of ETF shares agree on—as opposed to the value of the assets held by the ETF. One benefit of trading in this manner is that investors can buy and sell ETF shares throughout the trading day and instantly know the price at which they transacted.

Trading ETF shares in the secondary market, however, can impact the liquidity and the price of an ETF's shares. If an ETF has a lower trading volume (i.e., it is “thinly traded”) or if more market participants want to sell rather than buy an ETF, an investor may have to accept a lower price to sell their ETF shares in the short term. This risk will likely be pronounced during times of market stress. Any of these situations, among others, could lead to an investor selling their shares at a “discount” to what the ETF's underlying holdings are actually worth and/or losing their principal investment.

Other trading scenarios can cause ETF shares to trade at higher prices than what the ETF's underlying holdings are worth (i.e., buying shares at a “premium”). Purchasing ETF shares at a premium and selling those shares without a premium, or at a discount, can significantly affect the realized return earned by an investor. Such realized return can substantially differ from the return of the ETF's NAV, and, if applicable, the index the ETF may seek to track.

Similar to mutual funds, an ETF's investment strategy can also impact the ETF's ability to provide liquidity to shareholders. For example, ETFs that invest in less liquid or harder to price assets, such as fixed income (particularly high yield, bank loan, or other less liquid credit segments), emerging or frontier markets, small cap equities, commodities, cryptocurrency or alternative strategies such as private equity and private credit, have a higher risk that their shares will trade at a discount or premium to their NAV. Such divergences can be larger, more likely to occur, and/or longer-lasting than for ETFs holding more liquid securities.

ETFs rely on large institutions to make a market in their shares, which provides liquidity to the trading of the ETF and can help keep the market price of ETF shares closer to the ETF's NAV than it would be without such market-making activity. Although this process has been generally successful, market disruptions, new types of ETFs and/or other events can make it challenging for such institutions to continue their market-making activities. It is important to note that there is no guarantee that such market-making activities will continue. This means that ETFs can trade at discounts to their NAVs, which will negatively impact ETF shareholders, particularly those that need to sell their shares at such times.

Taken together, when considering an investment in ETFs, you should consider the effects of trading in the secondary market. In addition, certain platform providers may limit the availability of ETFs to retirement plans.

Lastly, it bears noting that mutual funds and ETFs can also differ in terms of how often each product discloses its portfolio holdings. Mutual funds, for example, publish their holdings after each quarter end. Many mutual funds also display their top-10 holdings throughout the year. By contrast, many ETFs publish their holdings on a daily basis. A minority of actively-managed ETFs, however, meaning those that seek to outperform an index or other benchmark, disclose their holdings less frequently than daily.

## *Money Market Funds*

Similar to mutual funds, shareholders in most money market funds may redeem their investments on any business day. While money market funds may have up to seven days to fulfill redemption requests, most do so the next business day. Even though money market funds are often used for cash management purposes, they are not guaranteed investments. An investment in a money market fund is neither insured nor guaranteed by the Federal Deposit Insurance Corporation or any other government agency.

Money market funds are subject to specialized rules that seek to mitigate the risk that a fund will be unable to meet redemption requests. For instance, “Institutional” money market funds (i.e., those that permit investments from corporations and institutional investors) generally must impose a liquidity fee if such a fund experiences net redemptions above 5% of its assets. The rules also allow Institutional money market funds, as well as “Government” money market funds (i.e., those that invest primarily in government securities) and “Retail” money market funds (i.e., those that limit their investors to natural persons), to impose discretionary liquidity fees under other circumstances. This is intended to help money market funds manage redemptions without negatively impacting shareholders who remain invested in the funds. Importantly, any liquidity fees will be taken out of an investor’s redemption proceeds. Please review a money market fund’s prospectus for more information on the use of liquidity fees.

It is also important to note that while money market funds have been known for maintaining a stable \$1.00 price per share, certain money market funds maintain “floating” NAVs, which means their share price fluctuates along with the value of the fund’s assets. Government money market funds, as well as Retail money market funds, may continue to utilize stable share prices.

If despite these tools, a money market fund cannot meet its redemption obligations or maintain a stable NAV (where applicable), the fund may seek permission from the SEC to permanently suspend redemptions or do so without SEC approval if the fund promptly liquidates its assets afterwards. In addition, if a money market fund that seeks to maintain a stable NAV experiences negative yields, it also has the option of converting its stable NAV to a floating NAV, or to cancel a portion of its shares (which is sometimes referred to as a “reverse distribution mechanism” or “RDM”). Investors in money market funds that cancel shares will lose money and may experience tax consequences.

In addition to money market funds, many investors utilize ultra-short bond funds for cash management purposes. Please note that ultra-short bond funds are not money market funds, and as such, may not make use of the specialized tools for money market funds described above. Ultra-short bond funds have floating NAVs and are subject to market risk and the risks associated with debt securities. Please refer to an ultra-short bond fund’s prospectus for more information regarding the fund.

Please note that money market funds can also be structured as ETFs. Unlike traditional money market funds, money market ETFs trade in the secondary market and their share prices fluctuate throughout the trading day based on supply and demand. As a result, while money market ETFs are managed in a manner similar to other money market funds, money market ETFs are subject to the same pricing and liquidity risks applicable to ETFs generally outlined above.

## **Fees and Expenses**

Fees and expenses are an important investment consideration because they reduce investment performance.

Although the overall investment costs an investor pays will generally depend on the types of funds being considered, whether an investor is utilizing a brokerage or an advisory account and whether any

commissions or sales loads are assessed, you should know that many ETFs are less expensive than similarly managed mutual funds. For example, in brokerage accounts, certain mutual fund and money market fund share classes, but not ETFs, are subject to so-called 12b-1 fees, which are ongoing fees charged against such fund's assets for marketing, distribution and/or shareholder services costs. Mutual funds, but not ETFs, also provide Morgan Stanley with compensation for providing record keeping and related services.

Further, Morgan Stanley charges most fund families a support fee, also called a revenue-sharing payment, on client account holdings in fund families. Although revenue sharing payments are generally paid by the sponsors of mutual funds, money market funds and ETFs, and not by the investors in such products, it bears noting that Morgan Stanley charges revenue sharing fees to more mutual funds than it does to ETFs.

Because Morgan Stanley generally receives more compensation from mutual funds than it does from ETFs, Morgan Stanley has a financial incentive to promote and recommend mutual funds, which is a conflict of interest. In order to mitigate this conflict, Morgan Stanley seeks to charge the same revenue sharing rate schedule for mutual funds and those ETFs that are subject to revenue sharing, and for advisory clients there are account type and program exceptions and the fees are rebated to clients. Likewise, 12b-1 fees are either not charged to advisory clients or the fees are rebated to advisory clients. Mutual fund administrative services fees are also rebated to advisory clients or subject to account type and program exceptions. Lastly, Financial Advisors/Private Wealth Managers and their Branch Managers do not receive additional compensation as a result of mutual fund or ETF revenue sharing payments or mutual fund administrative services fees received by Morgan Stanley.

For more information on 12b-1 fees, administrative services fees and revenue sharing payments, including the conflicts of interest associated with them, please see the brochures titled "Mutual Fund Features, Share Classes and Compensation," "Exchange-Traded Products: Features, Fees and Risks," and "Mutual Fund and ETF Revenue-Sharing Families," which are available at [morganstanley.com/disclosures](http://morganstanley.com/disclosures). Please see the applicable ADV brochure for additional information related to advisory accounts.

### **Tax Efficiency**

Although it can vary by fund, ETFs are in many cases more tax efficient than mutual funds.

Mutual funds, money market funds and ETFs are generally required to distribute dividends and net realized capital gains on their holdings to shareholders. Unless these products are held in a tax-advantaged account, investors will typically have to pay taxes on such gains and income. This is true even if the fund loses value during a given tax year.

Importantly, the manner in which ETFs create and redeem their shares typically allows ETFs to experience fewer net realized capital gains. For investors utilizing taxable accounts, investing in ETFs could increase their returns on an after-tax basis, as compared to investing in a similarly managed mutual fund. Please consult with your tax advisor on the tax implications of investing in mutual funds, money market funds and ETFs. Morgan Stanley does not provide tax advice.

### **Conclusion**

Mutual funds, money market funds and ETFs allow investors to pursue professionally managed and diversified investments in convenient packages. Each product, however, has different characteristics regarding pricing, liquidity risk, fees and expenses, and tax efficiency that should be considered.

**Please carefully review a fund's prospectus before investing. The prospectus contains important information about fees, risks and investment objectives and should be carefully considered before investing. To obtain a prospectus, contact your Financial Advisor.**

Investing in the products stated entails the risk of market volatility and possible loss of capital. The value of all types of investments may increase or decrease over varying periods.

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