MUTUAL FUND FACTS

A **mutual fund** is a pool of money similar to the money collected by the class investment club. A fund manager decides how to invest the money, with the goal of increasing the value of each share of the fund for the investors. That will happen only if the value of the investments chosen by the fund manager increases.

Investors may buy shares of **open-end mutual funds** each business day for the **net asset value** (**NAV** in the newspaper listing), the investment value of each share. The net asset value is calculated each day by dividing the total value of the investments by the number of shares. This is how you calculated the value of the shares of your investment club. You may also sell your shares in an open-end mutual fund any business day and receive the NAV.

There are more than 6,000 mutual funds. More Americans invest through mutual funds than by any other investment method. There are stock mutual funds, bond mutual funds, stock and bond mutual funds and money-market funds. There are mutual funds that specialize in almost any type of stock or bond. Some mutual funds which are called **index funds** buy the stocks that allow investors' returns to match a particular index. Index funds can provide more diversification than actively managed funds. In addition, the management fee (discussed later) should be lower because the fund manager does not have to research which stocks to buy and sell. For this reason, many experts advise buying a fund that tracks a broad market index if only one fund is bought. Some funds buy high-risk investments and some buy low risk investments.

How can you choose the right fund? Here are some factors to consider:

Performance. Buy mutual funds that you believe will perform well. Performance is the most important factor to consider. However, your consideration of performance must be tempered by how much risk you are willing to take. A mutual fund prospectus lists the stocks or bonds a fund owns and provides information on the fund's performance. However, past performance does not guarantee that the fund will do as well in the future. The fund manager is a key to performance. It is a good thing if the fund manager has had favorable results and has worked for the fund for a significant period of time.

Cost. A mutual fund company makes money by charging investors various fees. These fees are a cost to investors. The lower the costs, the better it is for investors – as long as performance is good. Here are some typical costs of mutual funds:

- Some funds charge a load. A **load** is a sales commission. It is usually a percentage of the price and can be as high as 8 percent. A front-end load is paid when you buy shares, and a back-end load is paid when you sell shares. A no-load fund does not charge a sales commission. If you need help in choosing a fund, you might consider paying an investment advisor a load or commission for advice. If you do not need help, choose a no-load fund.
- All funds charge a **management fee** and have expenses. The lower the management fee and the expenses, the better it is for investors.
- Some mutual funds charge a **12b-1 fee**. This fee, which can be as high as 1.25 percent of the fund's value, is used by the company to advertise the fund to the public. Unless the fund has great performance, avoid funds with 12b-1 fees.

Convenience. A fund that provides good service is very helpful to investors. Are the statements easy to read? Are the fund's telephone representatives knowledgeable and helpful? Is it easy to make additional investments in the fund? Can you buy small amounts of the fund? Can you exchange shares in the fund for shares in another of the company's funds? Some fund families have dozens of different funds for different investment objectives.

Advantages of Investing in Mutual Funds

Why buy a mutual fund? After all, you can buy stocks and bonds directly. Mutual funds have several advantages over buying individual stocks and bonds. These advantages can make the extra costs worthwhile.

1. **Professional Management.** A professional money manager chooses your stocks. The performance of your investment club depended on which stocks you bought. A professional manager might be able to do

this better than you can. If you don't think this is true, you can buy an index fund. An index fund follows a stock average such as the Dow Jones Industrial Average. You get average performance. Over the years, a majority of actively managed funds have failed to beat average performance.

2. **Diversification.** Diversification means you spend your money on several stocks and bonds rather than just a few. If one or two stocks or bonds in your mutual fund decrease sharply in value, your loss will be less than if you own only a few stocks or bonds. If a class investment club bought only one stock, it could have a greater loss or greater gain than if the club bought several stocks. Your risk is greater the fewer stocks you buy. A mutual fund may own 500 different stocks.

3. **Liquidity.** Liquidity means you can turn your investment into cash easily. You can sell a mutual fund at the net asset value (NAV) on any business day. Of course, you may need to sell the fund for less per share than what you paid for it, and lose money.

4. **Investment Objective.** There is a mutual fund for almost any objective or goal. When you determine your goals and the risks you are willing to take, you can probably find a mutual fund that matches them.

TYPES OF MUTUAL FUNDS

Low Risk Low Reward ↑	**Money-market funds** (short-term securities)
	Bond funds (corporate or longer-term government bonds)
	Income funds (high-dividend paying stocks and high-interest paying bonds)
↓	**Growth funds** (larger company stocks; long-term capital gains)
High Risk High Reward	**Aggressive growth funds** (smaller company stocks; short- and long-term capital gains)

QUESTIONS FOR DISCUSSION

A. What is a mutual fund?

B. A friend tells you, ''All mutual funds are the same." How do you reply to your friend?

C. What is an advantage of buying a "load" fund? What is a disadvantage?

D. What is an advantage of buying a no-load fund? What is a disadvantage?

E. What should you consider when deciding which mutual fund to buy?

F. More Americans own mutual funds than individual stocks and bonds. Why do you think this is so?

G. If you were able to buy mutual funds in the upcoming Financial Services Stock Market Challenge, what type of fund should you buy? Why?

H. What are the advantages and disadvantages of buying index mutual funds rather than actively managed funds?

I. If you want to buy a mutual fund so you will have money to buy a house 10 years from now, what type of fund should you buy? Why?