Mutual Funds

Individuals with excess dollars to put to work in some form of investment have an often-bewildering range of choices. An investor may decide to tackle the financial markets alone, and buy and sell investments directly, in his or her own name. A second option is to invest indirectly, using an investment medium known as a mutual fund.

What Is a Mutual Fund?

A mutual fund is an organization designed to pool the assets of many investors, to achieve a common purpose. The money raised is then invested in accordance with pre-defined goals. This mutual effort of a number of investors provides benefits that an individual, working alone, might not be able to receive.

- **Professional management:** Trained, experienced investment professionals provide the research, selection and monitoring skills needed to manage an investment portfolio.

- **Diversification:** Owning shares in a mutual fund allows an investor to participate in a diversified portfolio. Instead of placing all the eggs in one basket, diversification spreads the risk over many different securities.

- **Convenience:** Mutual funds offer many conveniences. Investment programs can be started with relatively small amounts of money. Dividends and other gains can be automatically reinvested. Many funds offer features to automate both contributions and withdrawals. Regular fund statements ease bookkeeping by tracking an investor's purchases, withdrawals and reinvestments, as well as providing tax information.

Types of Mutual Funds

Mutual funds are classified according to their structure and investment objectives:

- **Open-end mutual funds:** Mutual funds that issue as many shares as the public wishes to buy are called open-end mutual funds. When a shareholder wants to sell, open-end funds redeem all shares tendered.

- **Closed-end mutual funds:** Closed-end mutual funds are funds that have a fixed number of shares. Unlike shares in an open-end fund, where the fund itself sells and redeems all shares, the shares in a closed-end fund are traded on public exchanges.

- **Investment objective:** Mutual funds are also classified according to the investment objective of the fund. Examples of mutual fund investment goals include:

  - **Money market funds:** These funds invest in a variety of short-term, money market debt, such as Treasury bills or commercial paper.

  - **Growth funds:** Have an emphasis on long-term capital growth, usually through investment in common stock.

  - **Income funds:** Focus on providing high, current income, using bonds and other income producing securities.

  - **Balanced funds:** Strive to provide income and long-term capital gain. Both stocks and bonds are used.

Key Mutual Fund Concepts

- **Prospectus:** The Securities and Exchange Commission (SEC) requires that every prospective investor in an open-end mutual fund be provided a document called a prospectus. The prospectus contains valuable information concerning how the fund works, the fund's goals and risks, its history, and any expenses or charges involved. The prospectus is intended to provide the facts necessary for an investor to make an informed investment decision and should be reviewed carefully. For closed-end mutual funds, a prospectus is issued only when shares are first offered to the public.

- **Net asset value:** At the end of each business day, the managers of a fund will add up the market value of all securities held by the fund. The total market value is then divided by the number of outstanding shares in the fund. The result is the Net Asset Value (NAV) per share. For open-end funds, NAV is used to calculate the price per share for both purchases and sales. For closed-end funds, NAV measures only the value of the securities in the fund; the market price of shares in the fund can be higher or lower than NAV.

- **Load vs. no-load:** The term "load" traditionally refers to a commission paid to purchase shares in an open-end mutual fund. Funds which are no load do not charge a commission to purchase their shares. Even though a fund is no load, other fees or expenses may apply. Investors are encouraged to consult a fund's prospectus for a discussion of the fees and expenses charged by a fund.

- **Offering price:** This is the price charged to purchase shares in an open-end fund. For a load fund, it is the net asset value (NAV) plus the commission charged. For a no-load fund, offering price and NAV are the same.

Possible Risks

The risks involved in owning shares in a mutual fund are the same as those involved in directly owning the underlying securities. However, these risks are generally "spread" by the fund manager over a range of securities, to help minimize the impact of any one risk on the fund's performance as a whole.

- **Mutual funds holding stock investments.**

  - **Market risk:** The value of stock can fluctuate up and down. If stock purchased at a higher price is sold when the market is down, a loss will result.

- **Mutual funds holding bonds or other debt instruments.**

  - **Market risk:** The value of a bond will fluctuate, usually in response to changes in interest rates. If a bond is sold before it matures, the investor may receive more or less than originally paid.

  - **Default risk:** The possibility that the issuer of a bond or other debt will not pay either principal or interest.

  - **Inflation risk:** As fixed-return investments, bonds are subject to inflation risk; over time, the dollars received have less purchasing power.

Disclosure Notice

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