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All About Money

Start with Mutual Funds

A mutual fund is an investment company that collects money from many people and invests it in a variety of securities. The company then manages the money on an ongoing basis for individuals and businesses. Mutual funds are an efficient way to invest in stocks, bonds, and other securities for three reasons:

1. The securities purchased are managed by professional managers.
2. Risk is spread out or diversified, because you have a collection of different stocks and bonds.
3. Costs usually are lower than what you would pay on your own, since the fund buys in large quantities.

The combined stocks, bonds, and securities of a fund are known as its portfolio. Each investor owns shares, which represent a part of the holdings in the total portfolio.

Usually, investment companies have a variety of funds to sell. Examples of investment companies include Vanguard, Fidelity, Janus, T. Rowe Price, American Funds, and Dreyfus. These and other companies have many mutual funds with different investment objectives. Mutual funds can be bought directly from the investment company or from brokers, banks, financial planners, or insurance agents.

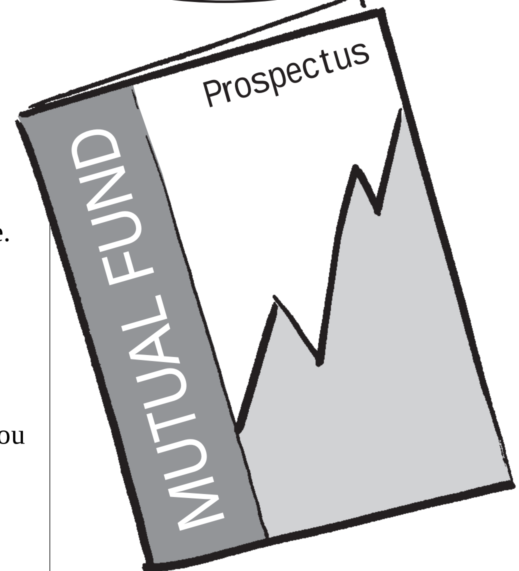
Before purchasing any fund:

- Know the types of funds available.
- Read the fund's prospectus.
- Study the fund's fee table.
- Consider the fund's objective and your investment objectives.
- Consider the other investments you have.
- Know the fund's performance.
- Read other financial information about funds you are considering.

Three Ways You Can Make Money on Mutual Funds

1. Dividends and Interest. A fund may receive income in the form of dividends and interests on the securities it owns. Bonds pay interest, and some stocks pay dividends. The mutual fund company will pass this income on to its shareholders. You generally will be taxed yearly on this amount unless the fund holds tax-free securities.

2. Capital Gains / Losses on Securities in a Fund. Prices of the securities in a fund may increase. When the fund then sells the security, the fund has a capital gain. At the end of the year, most mutual funds will distribute these capital gains minus any capital losses (reduced price) to the investors. These capital gains will be taxed each year they are received.



3. Net Asset Value (NAV) of the Mutual Fund. If the company does not sell but holds securities that have increased in value, the value of the shares of the mutual fund (NAV) increase and there is a profit. This also is a capital gain. However, you will not be taxed on this capital gain until the year you sell the fund.

Objectives of Mutual Funds

1. Income. Income funds focus on dividends and interest that provide income to investors. This is a relatively steady source of money, but the fund's NAV can still go up and down.

2. Growth. Growth funds focus on increasing the value of the principal or amount invested through capital gains and net asset values. Growth funds are usually more risky but offer greater potential return.

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3. Stability. Stability funds focus on protecting the amount invested from loss so the fund's NAV does not go down. This is the least risky type of fund but may make the least amount of money.

Types of Mutual Funds

Various types of mutual funds are available. These types are based on general categories of securities held in the funds.

Money Market Funds have relatively low risks compared to other mutual funds. They are limited by law to certain high-quality, short-term investments. Money market funds try to keep their value (NAV) at a stable $1 per share, but it can fall below that if the investments do poorly. Losses are rare, but possible. Their objective is stability of the fund.

Don't confuse a "money market fund" with a "money market deposit account." Banks have money market deposit accounts that are like a savings account and are insured by the Federal Deposit Insurance Corporation (FDIC). This is different from a mutual fund money market. The mutual fund owns other securities and its value is based on their performance. A money market deposit account is not a mutual fund. Banks may sell either or both, so be sure you know which type of money market you are getting.

Bond / Fixed Income Funds have higher risks than money market funds, but seek to pay more income than money market funds. Bond funds are not limited to high-quality or short-term investments, so they can vary dramatically in their risks and rewards.

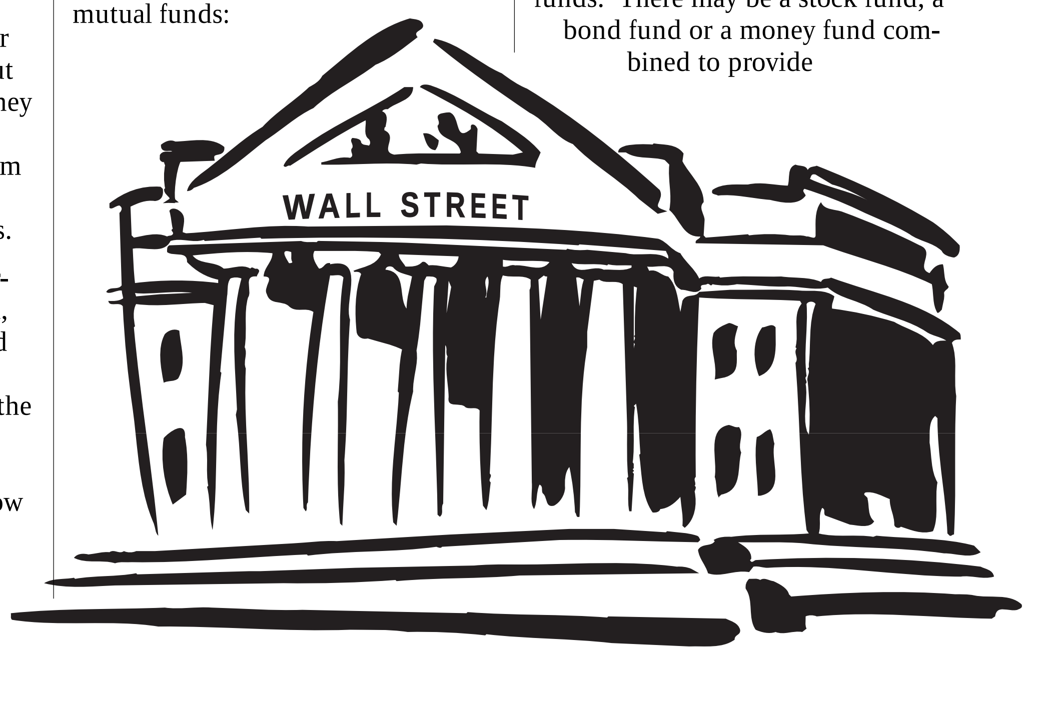
Because interest rates vary, the market value of bonds can rise and fall, so you can lose money in any bond fund. The longer the term of the bonds in the fund, the more risky the fund. Likewise, uninsured bond funds are more risky than insured bond funds. Bond funds rated below BBB are considered risky.

Equity / Stock Funds involve more risk than money market or bond funds but offer the highest potential returns. Usually, these funds focus on growth of capital gains and not so much on size of dividends paid. When the fund's objective is minimal to no income, it is considered an aggressive growth fund. A stock fund's value (NAV) can rise or fall rapidly over a short time, but historically stocks have outperformed other types of investments over the long term. A longer time period—at least five to ten years—is needed for this investment objective. Aggressive growth funds are classified as very high risk and should be considered as an investment for longer than a ten-year period.

Balanced Funds contain a mixture of stocks and bonds. This type of fund is a good beginning investment because it diversifies the portfolio with both stocks and bonds. Because stocks and bonds sometimes move in opposite directions (when stocks go up, bonds go down), this keeps a more even and less volatile portfolio. These funds combine objectives of conserving principal, paying current income, and promoting long-term growth of capital.

In addition to the four broad mutual funds categories already described, there are several specialty mutual funds:

- **International / Global Mutual Funds** invest in securities outside the United States or invest in both foreign and United States stocks. International funds are subject to currency risk or gain as well as a higher expense ratio.
- **Sector** funds specialize in certain markets, such as health care, technology, or precious metals. "Affinity" funds have emerged to reflect an investor's political or environmental concerns.
- **Index** funds attempt to hold the individual securities in major indexes such as The Dow Jones Industrial Average or the S&P 500.
- **Asset-Allocation** funds, a newer type of mutual fund, are a blend of stocks, bonds, and money market funds directed to the investor's risk tolerance. For example, a more aggressive asset-allocation fund invests 75 to 100 percent in common stocks and 25 percent in bonds, while a moderate risk asset-allocation fund invests 25 percent in stocks, 25 percent in money markets, and 50 percent in long-term bonds. A conservative asset-allocation portfolio is made up of money market funds and short-term or intermediate-term bonds with few or no stocks.
- **Fund of Funds**, another new type of mutual fund, is a combination of funds. There may be a stock fund, a bond fund or a money fund combined to provide



diversification. Be cautious because there are fees for the separate funds plus fees for the actual fund you are purchasing.

Selecting a Fund

- Find funds that match your investment objectives.
- Consider those funds rated in the top half of all mutual funds within the past 3-5 years.
- Compare a specific type of mutual fund to others in that same category.
- Study personal finance magazines to become familiar with investment and financial jargon, key concepts, and the way information is presented. Examples include *Kiplinger's Personal Finance Magazine, Money, Smart Money, Consumer Reports, Business Week,* and *Barron's.*
- Look for mutual funds that match your targeted fund category and investment objectives and have consistent returns, good past performance, and low fee structures.
- Determine how long the fund manager has managed the fund.
- Find an 800 number for the fund and request the most recent prospectus or look on the Internet.
- To narrow your search, go to the library or visit a stockbroker to use mutual fund reference books for more in-depth information. Such resources might include *Wiesenberger Investment Company Service, Morningstar's Mutual Funds, The Value Line Investment Reports, The Value Line No-Load Fund Advisor,* or *Mutual Fund Profiles.*
- Track the funds' performance in a daily newspaper with extensive financial pages or on the Internet.
- Be careful about investing before a capital gains or dividend/interest distribution particularly at the end of the year.
- Consider the risks associated with the fund.

Reading a Mutual Fund Prospectus / Profile

- Request a prospectus as well as a profile. The company must update the prospectus yearly.
- Check the fund objective to see if it matches your investment objective.
- Find the minimum investment needed. If the minimum amount is more than you have to invest, you can rule out the fund quickly.
- Examine investment risk. Does it match yours? How much risk are you willing to assume? If the fund's NAV goes down, will you hold it until it goes up again?
- Review the chart with summary of expenses. Compare the cost of investing $10,000 at 5 percent over one-, three-, five-, and ten-year periods and selling at the end of each period. This chart allows a standard for comparing two or more funds.
- Examine the best and worst returns for a quarter.
- Review the financial history chart.
- Compare past performance to total market performance or an index that is comparable to the fund.
- Examine the statement of fund organization. How long has the fund been in business? How large is it? Very large funds are more difficult to manage.
- Review shareholder services. Can you invest by telephone, mail, the Internet, exchange, or wire?
- Can you invest automatically each month from your checking account?
- How are earnings distributed?
- What is the minimum amount you must keep in your account?[1]

According to the U.S. Securities and Exchange Commission: "A fund's past performance is not as important as you might think. Advertisements, rankings, and ratings tell you how well a fund has performed in the past. But studies show that the future is often different. This year's No. 1 fund can easily become next year's below-average fund. (Note: Although past performance is not a reliable indicator of future performance, volatility of past returns is a good indicator of a fund's future volatility.)"[2]

Mutual Fund Volatility

In stock funds, volatility is measured by Beta. In bond funds, volatility is best determined by bond maturity. Bonds maturing in thirty years have more volatility than bonds maturing in five or ten years. For stock funds, the Beta number tells how volatile the fund is compared to the overall stock market. When the Beta is 1.00, the fund moves at the same rate as a comparable index, such as the S&P 500. When the Beta is .85, the fund will only rise 85 percent of the index, but it also falls only 85 percent as much as the index. When the Beta is 1.15, the fund will move 115 percent compared to its index, so there will be a larger gain but also a greater risk of losing more money than a comparable index. Research reports, like *Morningstar,* provide Beta.

Current Mutual Fund Fees

Mutual fund fees are reported in the prospectus or fund profile which can be obtained from a broker or investment company. The following sections report current fees.

Front-End Loads or Sales Charges—Range 0 to 8.5 Percent. This commission fee is paid for the initial investment and can range from 0 percent to 8.5 percent. The broker who selects and sells you the fund

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[1]Adapted from: Patricia M. Tengel. Mutual Funds Fact Sheet. University of Maryland Cooperative Extension Service.

[2]Securities and Exchange Commission, *Invest Wisely, An Introduction to Mutual Funds: Advice from the U.S. Securities and Exchange Commission,* Washington, D.C., 1996.

may receive a portion of this fee. Check for charges on dividends that are reinvested in the fund automatically.

Back-End Loads, Redemption Fees, and Exit Fees—Range 0 to 6 Percent. Some funds charge when you sell a fund soon after purchase. These loads will typically decline with each year you own the fund and disappear after you own it for a number of years.

12b-1 or Marketing Fees—Range 0 to .75 Percent. The U.S. Securities and Exchange Commission allows mutual funds to charge what is known as the 12b-1 fee to cover marketing and distribution costs. These fees are taken from the fund's assets each year. A mutual fund with a load can charge .75% of average net costs per year, while a no load fund can charge .25% per year.

Management and Administrative Fees—Range .2 to 2.5 Percent. All funds charge investors a management or administration fee that is a percentage of the total investment each year. These fees average 1.4 percent, typically with stock funds higher and bond funds lower.

Total Expenses

Total Fund Operating Expenses. This is a total of all the fund's annual costs—the bottom line, so to speak. Other fees to look for include maximum sales charges on reinvested dividends and exchange fees (per transaction), charges for switching from one fund to another in the same family.

Hypothetical Example: Each fee table ends with an example showing how much of your investment would go to expenses over one, three, five, and ten years. Each fund assumes a $10,000 investment and a 5 percent return each year and that you sell your shares at the end of the time period. This allows you to compare funds with different fees to determine how much the different fees will cost you.

Which Fees Are the Best? Consider the yearly costs carefully. Over a long time period these fees will add up, so look for funds with low yearly fees. If you are "sure" the price will go up, then the front-end fee may be best if you plan to pull out in a few years and you have compared this option with a back-end load. The fee table will make it easier to compare funds. However, a fund that has a higher fee may make you more money than a fund with a lower fee. Determine how much risk you are willing to assume for the higher fee and maybe higher return.

Other Considerations

Total Return. Measures the performance of the mutual fund with all income and capital gain distributions reinvested back into the fund. It also includes the change in the NAV but does not include any of the sale charges.

Record Keeping. Once you purchase a mutual fund, keep all the end-of-the-year statements from the company. Also keep the confirmations of all of your purchases. These will be needed when you sell the fund. It also is helpful to keep a copy of the prospectus and most recent annual report in your file. Notes from conversations with your broker should also be kept.

Summary

Since there are thousands of mutual funds, careful examination before purchasing and at least yearly monitoring of the fund's performance are necessary. Mutual funds are an excellent first investment. Remember that the stock market does go up and down and a long-term perspective is needed. Changing from one mutual fund to another is costly and not as productive as buying and holding a fund that performs well. Therefore, read the prospectuses and select a fund very carefully before investing. You need to consider your needs and your willingness to take risks.

For Additional Information

Ohio Division of Securities
1-800-788-1194
www. securities.state.oh.us/

U.S. Securities and Exchange Commission
450 Fifth Street NW
Washington, DC 20549
202-942-7040, www.sec.gov

Investing for Your Future
www.investing.rutgers.edu
or contact your local extension office

Mutual Funds Education Alliance
www.mfea.com

Alliance for Investor Educator
www.investoreducation.org

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