Chapter 4: Mutual Funds

Mutual Fund - The combining of many investor's funds into a single investment pool.

There are about 8,000 mutual funds available in the US.

<table>
<thead>
<tr>
<th>Year</th>
<th># Households w/ Mutual Funds</th>
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<tbody>
<tr>
<td>1980</td>
<td>5 Million</td>
</tr>
<tr>
<td>2001</td>
<td>55 Million</td>
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**OPEN END FUNDS**

- Most Common
- Sold ready to buy and sell shares from the fund at all times, as investors make purchases or redemptions.

**CLOSED END FUND** - A fund with a fixed number of shares that are traded on the stock market.

**NAV** = Net Asset Value = The value of the fund's assets divided by the number of shares outstanding.

Mutual Funds are like corporations who's job is to invest in securities for its owners. Each fund is a separate company, but families own them.
Mutual funds are not taxed at the fund level. Their earnings are passed through to the investors and are taxed at the personal level.

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**FEES**

1. **Sales Charge or "Load"** – Fee charged on the sale or redemption of the fund.

2. **12b-1 Fee** – Fee that is levied annually to support the marketing and distribution of the fund. Maximum is 1%. Not all funds have 12b-1 fees.

3. **Management Fee** – Fee levied to cover the cost of managing the fund.

4. **Trading Costs** – The cost of buying and selling securities

**Turnover** – A measure of how often the stocks in the fund are changed each year.

Trading cost is related to turnover.
Why pay loads & fees?
- Because someone is selling you the product.
- To minimize fees you need to buy the product

Some Types of Mutual Funds

1. Money Market Fund.
   - Invests in money market securities.
   - How low risk & are very liquid.
   - Funds typically allow you to write checks against them (say for $250 or more)

- Money Mkt funds set their NAV=1
- so it looks more like a checking or saving account.

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\[ FV = PV \times (1 + r)^n \]

\[ = 250,000 \times (1.043)^1 \]

\[ = 260,750 \]

- Would own at the end of the year 260,750 shares, because Money Mkt funds set stated NAV=1 on a daily basis.
2. Bond Fund - Invest in Bonds
   - Maybe short term, intermediate, or long term
   - Can be Govt., Corporate, or Mortgage
   - Can be "junk" or high grade bonds

3. Stock Funds - Invest in Stock
   - Growth Funds - buy growth stocks
   - Income Funds - pay high dividends
   - Mixed Stock -
     - Company Size Based
     - Other

4. International - As above, but throughout the world

5. Sector Funds
   - e.g., Health Care, Natural Resources, Medical etc.

6. Index Funds (my favorite)
   - aim is to mimic the results of an index (such as the S&P 500)

7. Social Conscience Funds - Do not invest in Sin

8. Tax Managed Funds - Goal is to minimize taxes by including low dividend paying stocks and hoping
9. Municipal Bond Fund - Invest in Muni Bonds to avoid taxes. May be state specific.

Exchange Traded Fund (ETF's)
- Like an index fund, traded on an exchange
  e.g. "Standard & Poor's Depository Receipts" SPDR, called "Spiders"
- Trade like a closed end fund i.e. have brokerage fees when trading

Hedge Fund - An unregistered investment company, not accessible to the general public, and is significantly less regulated than a mutual fund.
- Traditionally created "hedged" positions, but now an unregistered fund that can pursue any investment strategy it chooses.
- Need $50,000 to $1,000,000 for a minimum investment.