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The elements of success

Understanding Mutual Funds

Of the investments available to the public, mutual funds are easily among the most popular. Using a mutual fund, an average person can make use of a professionally managed and properly diversified investment without spending a tremendous amount of money.

However, eager investors should be aware that mutual funds are not without flaws. Fund investors are subject to certain fees and taxes and mutual funds, though diversified, still carry a certain amount of risk. By learning more about the features and costs of mutual funds, investors can make wise decisions about how to invest their money.

What is a Mutual Fund?

A mutual fund is a portfolio of securities (stocks, bonds, etc.) managed by investment professionals that pool money from multiple outside investors to fund the portfolio. As the portfolio makes money, most of the profits are distributed to the investors who bought shares of the mutual fund. The amount of profits an individual receives is proportional to the amount of money they invested. By buying a share of a mutual fund, an investor is essentially buying a tiny piece of every investment the fund has in its portfolio.

Mutual Fund Features

Mutual funds are popular with investors because of the variety of features they provide:

- *Professional investment* – Because their money is pooled together, investors are able to afford the full-time management of a mutual fund's resources. Mutual fund managers must have specific designations or licenses to manage a fund legally.
- *Diversification* – Even when a mutual fund only invests in one type of security, such as large cap stocks or commercial bonds, the fund still diversifies by investing in many different companies of that same type. Though one company might do poorly, another company might do well. Diversification can always be increased by investing in multiple mutual funds at the same time.
- *Regulated investments* – Any mutual fund must be registered with the Securities and Exchange Commission (SEC), accountable to a board of directors or trustees and the fund manager must be registered with the SEC as a Registered Investment Adviser (RIA).
- *Accessibility* – Mutual funds generally have a low cost of entry. Mutual funds do charge certain fees for the professional management, but openly report the costs so that investors can be aware of the fee structure. Additionally, mutual funds are very liquid; investors can cash out on any day the market is open.

Benefits

Investors can receive profits from mutual funds in a few different ways:

- *Dividends* – When a mutual fund makes money by receiving stock dividends or interest on bonds, the fund pays that money to its investors, minus expenses.
- *Capital Gains* – When a fund decides to sell a security it holds, if that security has increased in value since the fund purchased it, it will be sold at a profit. At the end of the year, the fund distributes any of these capital gains to investors, minus any capital losses from the year.
- *Increased Net Asset Value (NAV)* – When the market value of the mutual fund itself rises, investors may sell the fund at NAV minus expenses.

The Risks

Mutual funds carry with them all of the risks of the underlying investments within the fund's portfolio. Additionally, investors risk below-average management by the mutual fund. Many websites and resources offer reports that evaluate fund managers and compare the fund's performance to benchmarks and other similar funds. Finally, because funds charge various management and redemption fees, there is a risk that a fund may be more costly to own than the value of the underlying assets themselves.

Getting in and out of a Fund

Unlike stocks, which are bought and sold between investors, mutual fund shares are purchased from the fund either directly or through a fund broker. The purchase "price" is the NAV plus any fees charged at the time of purchase. When selling a mutual fund, you "redeem" shares of the fund.

Gathering Information

There are thousands of mutual fund options, each with unique advantages and disadvantages. Always research a fund before investing in it. Each mutual fund is required to file a prospectus and regular shareholder reports, which will provide the essential information you need to know about it. In addition to the fund's own literature, dozens of reliable websites contain in-depth analysis and research regarding mutual funds and their managers. But don't wade through that information alone, contact Hooker & Holcombe Investment Advisors, Inc. when looking for a mutual fund best suited to your unique investing needs.

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