

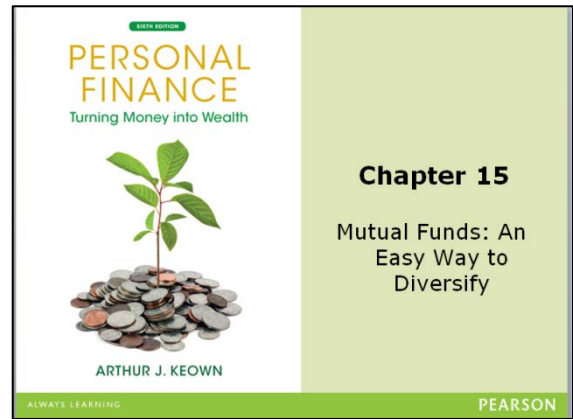
Notes and Reading Guide

Chapter 15

Mutual Funds

Name: _____

Introduction

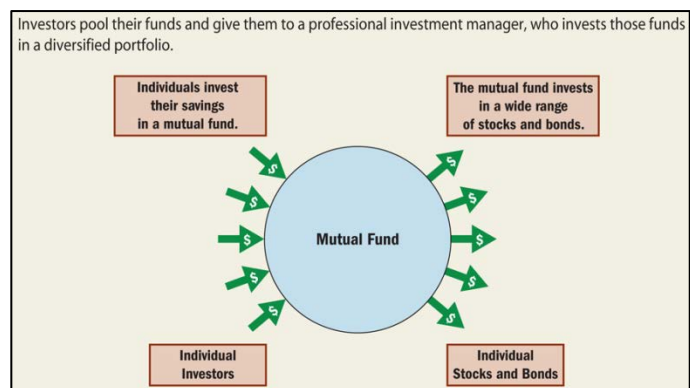


1. A **mutual fund** is an investment that _____ from investors, _____ the money, and invests it in _____, _____, and other investments. Each investor owns a _____ of the fund proportionate to his/her investment. A professional manager will _____ and manage the fund.
2. **Reading Guide.** Go to **pages 490-492**, and fill out the following information on advantages of mutual funds:
 - a. **Diversification.** For the small investor, this is an _____. If you have only \$10,000 to invest, it is difficult to diversify without paying _____. When you buy a mutual fund, you are purchasing a small fraction of the fund's _____ holdings.
 - b. **Professional management.** A mutual fund is an inexpensive way to gain access to _____. Mutual fund managers have access to all the best _____ from several brokerage houses. Professional managers are in a much better position to _____, especially alternative investments.
 - c. **Minimal transaction costs.** Because mutual funds trade in such large quantities, they pay _____ in terms of commissions. Over the long run, these lower transactions costs should translate into _____.
 - d. **Liquidity.** Mutual funds are easy to _____. Mutual funds are liquid enough to provide _____.
 - e. **Flexibility.** Given that there are over _____ different mutual funds to choose from, they cover many _____ and _____ levels. As an individual investor, you should be able to spell out your desired objectives and find a fund that meets your _____.
 - f. **Service.** Mutual funds provide _____ services, _____ accounts, automatic systems to _____ or _____ your account, and the ability to buy and sell with a single phone call. With a mutual fund, you can also automatically reinvest your _____, _____, and capital gains _____.
 - g. **Avoidance of bad brokers.** With a mutual fund you avoid the potentially bad _____, high _____, and _____ that can come with a bad broker. Remember that a broker's job is _____; brokers don't make money unless you _____. A mutual fund manager's job is to _____.

3. **Reading Guide.** Go to **page 492** and fill out the following information on disadvantages of mutual funds:
- Lower-than-market performance.** On average, approximately ____% of actively managed stock mutual funds underperform the market. That doesn't say much for the ability of mutual fund managers to _____.
 - Costs.** The costs associated with investing in mutual funds can _____ from fund to fund; investigate costs before _____. Some funds charge a _____ or _____ that can run as high as ____%, in addition to an annual expense ratio that can run up to ____%. You get charged those fees even if the fund is losing money!
 - Risks.** Not all mutual funds are _____. Some mutual funds may be diversified within that sector of the market, but not diversified across _____. As a result they tend to not be very well diversified because the stocks in different sectors tend to _____. Remember, diversification is a huge advantage of mutual funds, but choosing a nondiversified, segmented fund turns that advantage into a _____.
 - You can't diversify away a market crash.** If there is a market crash, investing in stock mutual funds isn't going to protect you because _____.
 - Taxes.** Normally you don't pay capital gains until you sell your stock. Mutual funds, however, tend to trade relatively frequently, and when they sell a security for a _____, you have to pay _____ on your capital gains. Mutual funds don't let you _____ your taxes—they make you pay as you go. However, in a retirement account, taxes are deferred until retirement.

Mutual Fund-Amentals

- A mutual fund pools money from _____ with similar _____. A mutual fund investor is investing in a _____ that is professionally managed according to _____. Investment objectives are _____.
- As the value of the securities in the fund _____, the value of each mutual fund _____ also rises. Most pay _____ or _____ to shareholders. Shareholders receive a _____ when the fund sells a security for _____ than originally paid.
- Funds are usually set up as a _____ or a _____. The shareholders elect a _____; the fund is run by a _____. Each individual fund hires an investment _____ to oversee the fund, supervising _____ and _____ of securities.



Investment Companies

- An **investment company** invests the _____ of a number of investors in return for a _____. The most popular type is an **open-end investment company or mutual fund**. These can issue as _____, and they account of ____% of all mutual funds.

8. **Net asset value (NAV)** is the price of a _____ of a mutual fund. It is updated _____ a day, at the _____.
9. **Closed-end investment companies** can't _____. Once all shares are initially sold, buying and selling takes place _____. The value of the shares is determined by the value of the _____ plus _____.
10. A **unit investment trust** is a _____ pool of securities, generally _____. The bonds are purchased and held to _____, at which point the trust is dissolved.
11. A **real estate investment trust (REIT)** is similar to a mutual fund, but invests in _____, such as _____ or rental property. These funds do not necessarily follow the _____, and they are subject to risks in the _____.
12. A **hedge fund** is a fund with very few _____. They charge high _____; they are very _____; and have no _____. Investors must have a net worth of at least \$_____ million to buy in.

The Costs of Mutual Funds

13. A **load** is a _____ charged on a mutual fund. A load fund is a mutual fund on which a _____ is charged.
14. There are three types of load funds:
 - a. **Class A shares** charge a _____ sales load, or fee paid when the funds are purchased.
 - b. **Class B shares** charge a _____ sales load (deferred), or fee paid when the funds are sold
 - c. **Class C shares** charge a fee on both _____ and _____.
15. A **no-load fund** doesn't _____. You deal directly with the _____.
16. The **expense ratio** is the ratio of a mutual fund's expenses to its total assets, typically _____% to _____% of your investment, even if the fund _____. A primary concern for investors is to invest in a fund with a _____.
17. The **turnover rate** measures the level of the fund's _____, or the _____ and _____ of securities. The higher the turnover rate, the higher the _____.
18. The **12b-1 fee** is an annual fee, generally ranging from _____% to _____% of a fund's assets, that the mutual fund charges its _____ for _____. Investors don't get any _____ from paying this fee. Funds with this fee don't _____ than comparable funds without the fee. Try to _____ funds with this fee.

Calculating Mutual Fund Returns

19. Returns on mutual funds can be in the form of _____, _____, or a change in _____ (or price per share of the fund). Automatic reinvestments of dividends result in _____ in the NAV and the _____ of shares you own. Calculating returns can help you spot funds that have been _____.

Types and Objectives of Mutual Funds

20. **Money market mutual funds** invest in _____, _____, and other short-term investments of less than ____ days. They carry no _____, trade at a constant \$ ____ NAV, and have _____ expense ratios.
21. A variation is a **tax-exempt money market fund**, which invests only in _____.
22. A **government securities money market mutual fund** invests only in _____.

Stock Mutual Funds

23. Of all the types of mutual funds, **stock funds** are by far the most popular. **Reading Guide.** Go to **pages 501-502** and fill out the following information about various types of stock mutual funds:
- Aggressive growth funds.** These funds try to maximize _____ while ignoring _____ (dividends). These funds go for stocks whose prices could _____, even though they pay small dividends. Ownership shares of aggressive growth funds tend to experience wider _____, both up and down, than do the share prices of other funds.
 - Small company growth funds.** Small company growth funds are similar to _____ except they limit their investments to _____. The purpose of small company growth funds is to uncover and invest in _____ with unlimited _____. These are very risky funds with a good deal of _____.
 - Growth funds.** Growth funds generally pay more attention to _____ firms that pay _____. Growth funds are less _____ than aggressive growth funds. Because of the stable _____, their shares tend to bounce around less in _____.
 - Growth-and-income funds.** These funds try to invest in a portfolio that will provide the investor with a steady _____ in addition to having the potential for increasing _____. Because of the steady _____ these funds provide, the shares tend to fluctuate in price _____ than the market as a whole.
 - Sector funds.** A sector fund is a specialized mutual fund that generally invests at least ____% of its assets in a _____. Sector funds tend to be _____ than traditional mutual funds because they are less _____. In fact, the idea is to _____ diversification.
 - Index funds.** An index fund tries to track a _____, such as the _____. It does so by buying the _____. Much of the value of an index fund comes from its low _____, which can be anywhere from ____% to ____% lower than those of other funds.
 - International funds.** An international fund concentrates its investments in securities from _____. Two-thirds of the fund's assets must be invested outside the _____. These funds open you to _____ and _____ risks not present with domestic stocks, so it is important to understand the _____ of all the countries represented in the fund.
24. A **balanced mutual fund** tries to balance objectives of long-term _____, _____, and _____. It holds both _____ and _____ and sometimes preferred stock.

It is aimed at those needed _____ to live on and moderate _____ in their investments. It will be less _____ than stock mutual funds.

25. **Asset allocation funds** invest in _____, _____, and money market securities. They move money between stocks and bonds to _____ by trying to practice _____.
26. **Life cycle funds** are mutual funds that try to tailor their holdings to the investor's characteristics such as _____ and _____. Target retirement funds are managed based on when you plan to _____: the closer you get to retirement, the more _____ the investments.

Bond Funds

27. **Bond funds** are mutual funds that invest primarily in bonds. They fluctuate in value with market _____. They can be used for _____ of money, to keep investments liquid. Otherwise, you would use _____ bonds because there is no professional management or fees. Types of bond funds are:
- U.S. Government Bond Funds or GNMA Bond Funds.** These funds invest in _____ or _____ mortgages.
 - Municipal bond funds** invest in _____ or _____ bonds; generally they are _____.
 - Corporate bond funds** invest in bonds issued by corporations. They can be _____. If the company fails, the bonds are no good and you lose all your money.
28. Maturities for bonds are short term (_____ years); intermediate term (_____ years); and long-term (_____ years).

Exchange Traded Funds (ETFs)

29. An **ETF** is a hybrid between a _____ and an individually traded _____ or _____. It trades on an exchange like individual _____ do, and can be _____ and _____ throughout the trading day. Like a mutual fund, it contains many _____ and other _____.
30. ETFs charge _____ annual expenses but still pay _____. They are more tax-_____ than most mutual funds. They allow investors to stake out an investment position in a _____, _____, or _____. Investors can make their move during the market's regular _____ hours.
31. **Reading Guide.** Go to **Table 15.4** on **page 507**, and fill out the following information about advantages and disadvantages of ETFs:

Advantages of Exchange Traded Funds
• ETFs trade on an _____ and can be bought and sold _____
• ETFs can be _____ or bought _____
• ETFs allow you to take _____ in a sector or country that you might not otherwise have access
• ETFs have very low _____

<ul style="list-style-type: none"> ETFs are more _____ than most mutual funds
Disadvantages of Exchange Traded Funds
<ul style="list-style-type: none"> Because ETFs trade the same as common stocks, you pay _____
<ul style="list-style-type: none"> ETFs don't necessarily trade at their _____
<ul style="list-style-type: none"> You buy the ETF from another investor, so you also have the _____ spread to deal with. For example, you might be able to buy the ETF at \$25, but only be able to sell it later for \$24.85
<ul style="list-style-type: none"> For investors who trade frequently, ETFs can be more _____ than typical mutual funds. That's because you incur _____ each time you buy or sell them.

Mutual Funds Services

32. Your mutual fund will allow for automatic _____ and _____ plans. You can make automated regular _____ while you are working and _____ when you are retired. They also allow for automatic reinvestment of _____, _____, and capital _____. You can also arrange to have your funds sent to your _____ on the same day each _____.
33. It is easy to manage your funds using _____ and _____ access. There is easy establishing of retirement plans—the fund will handle _____ and give you _____. Check writing is possible with _____. Some funds also offer _____ and help with _____. Taxes can be complicated, and some funds will _____.

Buying a Mutual Fund

34. **Step 1: Determine Your Goals.** Look at questions such as: when will you _____? Are you investing for _____, _____, _____ for children? Tax-_____ investments? What is your _____? How risky do you want to be?
35. **Step 2: Meeting Your Objectives.** Look at _____ of funds and their objectives. Morningstar provides an investment style box to understand the fund's _____.
36. **Reading Guide.** Go to **Table 15.5** on **page 510** and answer the following questions about on-line information for mutual funds:
- Securities and Exchange Commission. Website: _____ **Features:**

 - SmartMoney Fund Compare. Website: _____ **Features:**

 - SmartMoney Mutual Fund Map. Website: _____ **Features:**

d. Wall Street Journal Mutual Fund Screener. Website: _____ **Features:**

e. Yahoo Finance Mutual Fund Screener. Website: _____ **Features:**

f. Morningstar Mutual Funds. Website: _____ **Features:**

37. **Step 3: Selecting the Fund.** Mutual funds are required by law to offer a **prospectus**, which is a description of the mutual fund, including its _____ and _____, its _____, the manager's _____, and other information. Internet screening is also helpful. Two sites are _____ and _____.

38. **Reading Guide.** Go to **Checklist 15.1** on **page 511** and fill out the following information on questions you should ask before buying a mutual fund:

- a. How has this fund performed _____?
- b. Have I obtained an _____?
- c. What specific _____ are associated with this fund?
- d. What type of _____ does the fund hold? How often does the portfolio _____?
- e. How does the fund perform compared to _____ or to an _____ of the same type of investment?
- f. What is the fund's _____?
- g. How much will the fund charge me when I _____? What other _____ are charged?
- h. How _____ is this fund?

39. **Reading Guide.** Go to **Table 15.6** on **page 511** and answer the following questions about what is in a mutual fund's prospectus:

- a. The fund's _____ and _____ strategy.
- b. The fund manager's _____. Many times when the mutual fund manager changes so does the _____.
- c. Any investment's limitation that the fund might have. For example, can the mutual fund _____?
- d. Any _____ of importance to investors.
- e. The _____ and _____ for _____ and _____ shares of the fund.

- f. _____ to investors. For example, does the mutual fund _____ ?
- g. Performance over the last _____ or since the fund has been in existence.
- h. Fund _____ and _____. Look closely at the fund's _____ and _____ charges. Also look for fees for marketing expenses, called the _____ fees.
- i. The fund's annual _____ rate, or how often the fund trades securities in and out of the fund.

40. **Reading Guide.** Go to **Table 15.8** on **page 513** and answer the following questions about screening criteria for mutual funds:

- a. **Load Funds.** Avoid both _____ funds and those with _____.
- b. **12b-1 Fees.** _____ them; there are plenty of _____.
- c. **Expenses Ratio.** Keep it under _____%
- d. **Turnover Ratio.** Focus on funds with _____ turnover; they are liable for _____ and they product _____.
- e. **Morningstar Rating.** Morningstar's star rating compares _____ to _____; you want to start out screening for _____.
- f. **Historical Returns.** Look for strong returns over the past _____ and _____ periods.
- g. **Morningstar Risk.** _____ is better; that way, you know the fund hasn't done well because it made _____.
- h. **Initial Investment.** Make sure you pick a fund that _____. Some funds require _____ initial investment.
- i. **Manager's Tenure.** Avoid a fund if the manager has _____ because historical returns mean nothing once _____.

41. **Step 4: Making the Purchase.** You can buy mutual funds directly from the mutual fund companies by _____ or _____. You can also buy through a mutual fund "supermarket" such as _____ or _____, which offer funds from _____.