Knowledge is Retirement Power

Mutual Funds for your Future

Scratching the Surface

Mutual funds pool your money with other investors who share the same investment goal. The fund manager invests and manages the pool of money to try to achieve the desired goal. As a mutual fund investor, you own shares of all the fund's holdings. You share in the gains and losses that the fund's holdings produce based on how many shares you own.

Here is a general overview of the three major types of mutual funds found in most retirement plans:

To help you in your learning process, look for these symbols:

KNOWLEDGE BOOSTER
Expand your knowledge and tips!

HONOR ROLL
A variety of trivia, fun exercises, and brain-teasers.

Money Market Funds also include stable value investments. Generally speaking, they invest your money in very short-term, high-quality securities issued by the U.S. Government and its agencies, U.S. corporations, and state and local governments. They carry little market risk but may offer a lower long-term return, which can weaken your strategy for growth and your ability to manage inflation risk.

Bond Funds invest your money in bonds issued by corporations, governments, or government agencies. They have higher market risk than money market funds and have a higher potential return. The issuers of the bonds in the fund's portfolio are actually borrowing money from the investors in the fund for a specific period of time, known as the term. The money they borrow from the investors in the fund is known as the principal. They promise to pay it back with interest by a certain date, called the maturity date.

Stock Funds make up the majority of investments in a typical retirement plan. Compared to bond funds and money market funds, stock funds represent the highest market risk, along with the highest return potential over the long term. There are more stock funds, and more varieties of stock funds, than any other type of mutual fund.

How much money would you guess is invested in mutual funds today?

A) $10.8 million
B) $10.8 billion
C) $10.8 trillion

Source: Investment Company Institute January 2010
Answer: C.

Where was the nation's first mutual fund introduced?

Hint: It's a city known for baked beans, crème pie, and the "Green Monster."

Answer: Boston

Mutual Funds offer three major benefits:

Professional Management
Professional money managers decide when to buy, sell, and hold securities within a mutual fund. They consider factors like the financial health of a company, industry trends, and the general state of the economy.

Diversification
By pooling your money with other investors, the fund manager can purchase a greater variety of investments than you could afford to buy on your own. A greater variety of investments gives you more diversification, which can help reduce risk.

Cost Effectiveness
History has shown that people who invest in the stock market have the potential for higher returns than those who put their money in more conservative investments.* Mutual funds make these potentially higher returns accessible to investors who otherwise would not be able to afford to buy individual securities, even those who can only afford to contribute a small amount to their retirement plan each pay day.

*Past performance is no guarantee of future results.

According to the Investment Company Institute, 92 million individuals in the U.S. invest in mutual funds.

What is Inflation Risk?

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What is Market Risk?

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Some retirement plans also offer "specialty" funds. Among the most common are **index funds**, **global funds**, **foreign funds**, and **sector funds**.

Index funds are designed to produce the same return that you would get if you owned all the stock in a particular index, such as the S&P 500. There is a wide variety of stock index funds that track almost every known index for large-, mid- and small-cap companies, as well as bond market indexes and several international indexes.

Global funds buy securities in countries all over the world, including the United States. In fact, some global funds may invest up to 75% of their assets in U.S. markets. Keep in mind that global funds tend be of higher risk due to changing political climates and the rise and fall of currency valuations.

Foreign funds buy securities all over the world, except in the United States. Foreign funds may offer you the opportunity to diversify into young, dynamic markets that are early in their growth cycle. Again, foreign funds tend be of higher risk due to changing political climates and the rise and fall of currency valuations.

Sector funds focus on the stocks of a particular industry or segment of the economy, such as technology, health care, or financial services. Although sector funds may be more diversified than buying a single stock, there is nothing in the fund's portfolio to offset a downturn in its sector. Because of their volatility, sector funds are appropriate for investors willing to take on a greater degree of market risk.

Match the following specialty funds with the type of company it might include in its holdings:

Foreign Fund	Bank of America
Sector Fund	McDonald's & Telefonos de Mexico
Global Fund	Volkswagen

The Substance & Style of Stock Funds

Depending on your tolerance for risk, years to retirement, and financial goals, you may want to consider some growth-type investments (such as stock mutual funds) in your portfolio.

Substance

Stock funds are sometimes identified as large-cap, mid-cap, or small-cap. That's because these funds are designed to invest in companies of different sizes, as measured by their market capitalizations, or "market caps." Market cap measures a company's size by multiplying the number of shares outstanding by the stock's price. Here's an overview of the three market cap categories:

Large-Cap (over $10 billion).* Large-cap companies, such as General Electric, Ford, and IBM, are well established and generally pay steady shareholder dividends. Their vast size and maturity typically makes them less responsive to market conditions and slower growing; however, their stability typically can make them well positioned to weather inevitable economic downturns and the resulting market volatility. Large-cap funds are considered to have less risk associated with them versus mid- or small-cap funds.

Mid-Cap ($2 to $10 billion).* Mid-cap companies are generally established yet innovative and responsive companies with the potential for continued, healthy earnings growth. Their larger capitalization base tends to make them less risky than smaller-cap stocks, though typically with slightly lower long-term historical returns. Mid-cap funds are considered to have greater risk associated with them versus large-cap funds, but less risk than small-cap funds.

Small-Cap (less than $2 billion).* Small-cap companies have the potential for rapid acceleration in earnings and growth. They can be highly volatile, but they are often viewed as companies that are on the cutting edge of their industries. Many small-cap companies effectively respond to market changes, but they may also have difficulty weathering economic downturns. Small-cap funds are considered to have more risk associated with them versus large- or mid-cap funds.

*Source: investopedia.com

If a company has 10 million shares outstanding and a price of $50 per share, what is the company's "market cap?"

Would you classify this company as small-, mid-, or large-cap?

Style

Some of the stock funds offered through your retirement plan may be categorized as either growth or value funds. The difference between the two is a matter of management style—the approach that a portfolio manager uses to choose the fund's investments.

While two stock funds may have the same investment objective (long-term growth, for example), their holdings may be very different.

A growth fund may invest in the stock of companies that the manager feels are up-and-coming new companies, or companies on the cutting edge of new technologies. It is usually companies with above average growth potential. In its early stages, Microsoft fit into this category.

A value fund invests in stocks that the manager considers underpriced and expects to rebound in value.

Knowing what's inside a stock fund can help you build a well-diversified investment plan.

Combine Substance & Style

Take the case of growth and value styles of investing. Although both growth and value funds may provide strong returns over the long term, their returns will probably be significantly different over the short term. That's because growth stocks tend to do better under a different set of economic circumstances than value stocks (and vice versa).

When it comes to selecting stock funds, you may want to consider a mixed approach. For example, you might look for a small-cap fund that buys some value stocks and some growth stocks, or a growth fund that buys both large-cap and small-cap stocks. You'll want to make sure you read the prospectus carefully before investing in any fund, and keep in mind your tolerance for risk, your years to retirement, and other financial goals.

Fees Associated With Mutual Funds

Have you ever wondered how a mutual fund company makes money? Here is a general summary of the fees associated with investing in mutual funds:

Management fees are charged by the advisory firm for the investment management functions it performs. Such functions include the day-to-day tasks involved in the researching, buying, and selling of securities on behalf of the fund.

12b-1 fees are charged in order to pay a portion or all of the costs of marketing and distributing the fund's shares to investors.

All mutual funds offered through retirement plans deduct management fees from the fund's total earnings. Some mutual funds also deduct marketing and distribution fees, 12b-1 fees, from the fund's total earnings.

In addition, mutual funds may charge a sales commission, commonly referred to as a **"load."** Funds available through your qualified retirement plan waive the sales charge normally associated with investing in the fund. The fund prospectus details any fees and expenses associated with investing in the fund.

Additional Resources

Mutual Funds for Dummies
by Eric Tyson and James C. Collins

Morningstar
www.morningstar.com
(Free registration is required)

Investment Company Institute
www.ici.org

Mutual Fund Education Alliance
(www.mfea.com)

Fund Your Future: Winning Strategies for Managing Your Mutual Funds and 401(k)
by Julie Stav

How Mutual Funds Make Money for Investors

When there is an increase in the value of the fund's investments, there is generally an increase in the value of the investor's shares. The value of an investor's shares, known as net asset value (NAV), is calculated at the end of each business day and can move up or down.

A fund's NAV is the current dollar value of one share in the fund. It's also the price the fund would pay you if you were to sell your shares. NAV is figured by totaling the value of all the fund's holdings and dividing by the number of its outstanding shares (less management fees). A fund's NAV increases when the value of its holdings increases. For example, if the NAV of a stock fund was $20 a year ago and is now $25, it means that the value of its holdings increased 25%. The NAV found on your fund profiles is net of all fees.

Knowledge Booster

In addition, a mutual fund may earn dividends or interest on the investments it owns. It may also sell investments that have gone up in price, producing capital gains. It pays out its earnings and capital gains (minus any fees and expenses) to you and the other investors in the fund. When you invest in a mutual fund through your retirement plan, any interest, dividends, and capital gains earned by the fund are reinvested in the fund, increasing the number of shares you own. Furthermore, no taxes are due on these earnings while they are in the plan. This tax-deferred compounding can allow your account balance to grow much faster over the long term!

The mutual funds you select in your retirement plan portfolio will play a major role in your search for retirement treasure. Investing for retirement is about identifying the mutual fund, or group of funds, that most closely matches your overall tolerance for risk, your investment time frame, and financial goals. As you map out your investment strategy, keep in mind all the choices available to you and the role each can play in building a diversified portfolio. Remember to start your search as soon as you can, invest regularly, and make sure you maintain a long-term outlook.

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