Introduction to Mutual Funds

If you know absolutely anything about investing, then you have probably heard of mutual funds. Once an obscure investment vehicle, they are now popular with almost all investors. If you ask your average investor whether they have any of their investment dollars allocated to a fund, they will likely answer yes. There are literally trillions of dollars of American money currently invested in mutual funds.

Funds have made investing for the average investor a little less complicated. A person no longer has to sift through stocks individually in the newspaper or spend hours watching the financial news on television. You can simply select a diversified fund that contains a bunch of different stocks of companies that fit into a certain paradigm, such as a fund containing nothing but small cap stocks, mid-cap stocks, large cap stocks, technology stocks, bonds, etc.

A mutual fund is really an investment company in and of itself, with a manager and other officers who administer it. When you buy shares, you are buying a portion of the holdings of the fund, which contains many different stocks and bonds within the portfolio. And, just like with individual stocks and bonds, your shares increase in value when the share price of stocks within the portfolio appreciate, or when interest payments are made on the bonds. As with stocks, you can sell your shares in a mutual fund at any time.

There are many different types of funds. They vary based on composition (stocks, bonds, or fixed income securities such as money market instruments), and strategy. Some funds, as already mentioned, invest in companies that have a particular market capitalization (i.e. large cap, mid cap, small cap). Other funds invest solely in foreign companies, while some invest in certain sectors within the economy, such as the financial, technology, or industrial sectors. Also, some mutual funds may pick companies based on ideology, such as a socially responsible or environmental fund. There are also index funds that simply invest in companies that are contained within a certain index, such as the Dow Jones, or the S&P 500.

The most important thing to understand when looking for a mutual fund is the cost structure. There are four expenses you need to review before investing. The first is the management expense, which is a charge assed on your money to pay the manager of the fund. The second is the administrative fee, which is usually assessed annually to cover the costs of mailings, postage, etc. The next fee is the 12B-1 fee, which covers the cost of marketing and promotion. And finally, there are sometimes front-end loads and back-end loads. A front-end load is a sales commission charged as soon as you open the account and invest your money. A back-end load, also known as a deferred sales charge, is assessed on your money when you close the account. Back-end charges vary depending upon how long you have had the account.

I hope this information has helped you to familiarize yourself with mutual funds. Try to set aside some money for investing and start while you are still young. The earlier you begin, the more money you can potentially make down the road. Carefully examine the fee structure and investment strategy before investing and you should do fine.

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