Money matters

Investing in Mutual Funds

The idea of a mutual fund may sound complicated. However, this type of investment is often a good choice for people who want a relatively simple way to invest their money as they journey toward retirement.

A mutual fund is a collection of stocks, bonds or cash-type investments such as a money market fund—or some combination of these. Reasons to invest in mutual funds include: they are easy to buy and sell, are managed by someone other than you, and they give you a better opportunity to protect against investment loss than buying individual stocks or bonds.

How They Work

When you buy shares of a mutual fund, you own a bit of various stocks or bonds or other investments in the fund. Buying shares of the mutual fund helps you to diversify—to spread the risk of losing your money among many different investments.

The fund buys and sells stock guided by the fund's objectives, which are outlined in a public document called a prospectus. Investments in a mutual fund are chosen by a professional manager based on certain investment objectives. For example, a stock fund might invest only in the stock of large companies; or in a particular industry, such as health care.

Before you choose a mutual fund, get information to help you decide on two important factors—the fees

Choosing the Right Mutual Funds

There are many types of funds to choose from. Here are some common ones:

- **Stock funds**—a pool of money invested in the stocks of many companies. Its objective is typically to grow the money over a long period. These funds consist of certain categories of stocks. For example, a fund may invest entirely or mostly in large or small companies, in foreign companies, in a particular industry such as health care, or in stocks of "socially responsible" companies.
- **Bond funds**—a collection of bonds purchased with pooled money from many investors. When one buys a bond, the purchaser lends money to a company or a government entity, like a county or a state to use the money for a project such as building a road. You pay a specific amount to buy the bond, and the issuer agrees to pay the money back over time with interest. The objective is typically to provide income for investors. Bond funds are generally less risky than stock funds, but they can gain or lose value. The safest ones invest in bonds issued by governments, including the U.S. Treasury. Bond fund values go up or down as interest rates change.
- **Money market funds**—the safest mutual funds made up of short-term, low-risk loans. They don't provide high returns, but they do protect your money.
- **Index funds**—a mutual made up of practically all securities in a particular index such as the S&P 500 index. There are many types of index funds. Some just track stocks of small companies or large companies; others may invest in foreign companies or in bonds. If the index goes up, the fund makes money. If it goes down, the fund loses money. Index funds usually have low fees.
- **Balanced funds**—a mix of stocks and bonds that provides some opportunity for your money to grow, along with safety and current income. A typical balanced fund may be 60 percent invested in stocks and 40 percent invested in bonds.
- **Life cycle funds**—also known as "target retirement date" funds designed to meet all of your investment needs in one fund. You buy shares of a fund based on the date when you will retire. For example, if you want to retire in about 25 years, you might invest in a 2030 fund.

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you'll pay and how the fund fits in with your own investment goals and timeline. If you decide to buy more than one mutual fund, look at their investment objectives and holdings, to make sure you are not unintentionally making the same investments twice.

Buying and Selling

Many people first encounter mutual funds when they must decide how to invest their 401(k) or other retirement account at work. In this case, all you have to do is select the fund, or funds, that you believe meet your investment goals. You should choose based on when you expect to retire and how much investment risk you're willing to take. If you want, you can also buy and sell the funds inside a regular brokerage account, or by contacting the fund directly.

Watch Out for Fees

When you buy a fund, check on the fees you'll have to pay, because these can reduce your earnings. Here are some of the types of fees you might hear about:

- **Front-end load:** The commission charged when you buy a fund. If you invest $1,000 in a mutual fund that has a 5 percent load, for example, you are really only investing $950.
- **Back-end load:** The fee charged when you sell the fund.
- **Expense ratio:** The annual costs of operating a fund. The higher the percentage is, the more money comes out of your investment. Let's say you invested $1,000 for 20 years at an 8 percent return. Here's how the expense ratio would affect your investment:

Expense Ratio	Value of $1,000 in 20 years
0.25%	$4,248
1%	$3,870
1.5%	$3,524

The Mutual Fund Advantages

Some reasons to consider investing in mutual funds are:

- **They reduce your risk of losing money.** Mutual funds invest in many stocks or bonds, so while some may perform poorly, others may perform well.
- **They are easy to get into.** You can buy into some funds for as little as $100 a month. Once you've chosen funds, you may be able to invest in them automatically within your within your 401(k).
- **They are easy to get out of.** You can sell your shares at any time, although you could lose money depending on the fund's value when you sell it.
- **They are managed by professionals.** Financial experts decide how to invest your money based on the fund's objectives, or by a broad-based index formula.

Your To-Do List:

- ☐ **Read "Invest Wisely,"** at www.sec.gov/investor/pubs/inwsmf.htm, a guide to mutual funds published by the federal Securities and Exchange Commission.
- ☐ **Learn more about mutual funds, including index funds**, at AARP's website at www.aarp.org/money/finance.
- ☐ **Before you select funds, choose an "asset allocation" strategy**—what portion of your investments should be bonds versus stocks, versus other investment types. Read more about allocating your money at www.aarp.org/finance.
- ☐ **Explore mutual funds** at marketwatch.com, Morningstar.com, and lipper.com. You can compare different funds by investment objective, performance, fees and risk level.
- ☐ **Before you buy a fund, add up the fees using the Securities and Exchange Commission's mutual fund cost calculator**, by clicking "Calculators" under Investor Information at www.sec.gov.

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