Introduction to Mutual Funds

Welcome
The Webinar Will Begin at 12:00 EDT

Introduction to Mutual Funds

Cooperative Extension

• Nationwide educational network.
• Each state and territory
  – Land-grant university and a network of local and regional offices.
• Reaching out
  – Extends the education and research from the university into the local community
  – Solve public needs with university resources through non-formal programs

Cooperative Extension in Florida

• Partnership between University of Florida & County Governments
  – All 67 counties in Florida have Extension offices
  – Most have a Family & Consumer Sciences Agent
  – Main website www.SolutionsForYourLife.com

Webinar Team

For More Information, Contact:
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Introduction to Mutual Funds

Please complete the SHORT evaluation that sent following the webinar.

This webinar is approved for 1 CE for AFCPE for AFC

Sources & Resources

• Montana State University
  – http://www.msuextension.org/solidfinances/pastrecordings.html
• Securities and Exchange Commission
• Investment Company Institute
  – www.ici.org
• Financial Industry Regulatory Authority (FINRA)
  – http://www.finra.org/Investors/SmartInvesting/ChoosingInvestments/MutualFunds/
• Dr. Michael Gutter, Mutual Funds, 2011 webinar

Today

• Focus of today’s discuss will be on open-end funds
  – Sell an unlimited number of shares
• Next time a comparison of open end mutual funds and exchange traded funds
• Closed-end funds
  – Sold through an Initial Public Offering (IPO)
  – Traded on an exchange

Poll Question:
People Can Own Mutual Funds

1. Through employer sponsored retirement plans
2. 529 plans
3. Individual Retirement Accounts
4. Annuities
5. All of the above
6. None of the above

What is a Mutual Fund?

• An investment company pools the assets of many investors to purchase securities
• Funds can be invested in stocks, bonds, money market instruments, real estate, precious metals
• Investors buy shares in the fund
• Provides diversification to reduce risk

Types of Mutual Funds

• Many, many types
• Examples:
  – Stock Funds
  – Bond Funds
  – Balanced Funds (stocks & bonds)
  – Specialty Funds
    • Invest in specific market or sector
  – Money Market Mutual Funds
    • Cash Equivalents
    • Different from a Money Market Deposit Account

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Fund Objectives

- Each fund will have a specific objective
- Some general examples
  - Growth
  - Income producing (dividend paying)
  - Social responsibility
  - Track an index

Advantages of Mutual Funds

- Diversification
  - Cost effective way to achieve diversification
- Affordability
  - Can often get started with small amounts
  - Allows for regular small deposits
- Liquidity
  - Can sell shares back to the investment company
- Professional Management
  - Professionals make decisions
  - Advantages and disadvantages

Disadvantages of Mutual Funds

- Funds held outside of a tax advantaged plan
  - Taxes on capital gain & dividend distributions
  - Even when you reinvest distributions
- Lack of control of exactly which securities are purchased
  - Decided by fund manager
  - Index being tracked
- Risk
  - No guaranteed return
  - Market fluctuation

Why Invest in Mutual Funds?

- General investment
- Retirement planning
  - Individual
  - Workplace
- Saving for education
  - 529 plans

How Can You Profit?

- Dividend Distributions
- Capital Gain Distributions
- Net Asset Value increases and you redeem (sell) the shares
- You can reinvest:
  - Dividends
  - Capital gains distributions

Net Asset Value

- A share in a fund is purchased at NAV (plus sales charges & fees)
- Per share Net Asset Value=
  \[
  \text{Total Assets} - \text{Total Liabilities} \\
  \text{Number of Shares Outstanding}
  \]

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Net Asset Value of Mutual Funds

- NAV is calculated at the end of day
- If you purchase based on NAV, end result may be different if NAV rises
  - Purchase based on NAV early in the day
  - NAV at the end of day may be different
- May increase, decrease or stay the same

Redeem Shares:
Will you have a capital gain?

- $$\text{\$\$\$} = (\text{NAV} \times \# \text{shares}) - \text{fees, commission}
  - \text{Capital Gain}
  - \text{Capital Loss}

Taxes

- Earnings in tax advantaged plans grow tax free
  - Retirement plans, 529 plans
- Outside of those plans, taxes paid on distributions even if reinvested
  - Long-term capital gains tax rate is less than tax rate for ordinary income
  - Capital losses can be used to offset capital gains

Taxes

- When you sell you have a capital gain, loss or break even
  - Tax liability depends on amount gained or lost
- Amount of Capital Gain/Loss
  - Sales Price – Cost Basis
- Cost basis is purchase price (includes any fees, commissions, etc.)

Methods for Calculating Cost Basis

- Average Cost
- First In First Out Methods (FIFO)
- Specific Identification

Purchasing Mutual Funds

- Broker
  - Full Service
  - Online
- Directly from the investment fund company
- Through employer sponsored plan

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**Introduction to Mutual Funds**

**Investment Decisions**

- Timeline
- Risk
  - Safety of investment
  - Individual comfort level
- Liquidity
  - Can you access when needed (and what will be the cost)
- Tax consequences

**Investment Decisions – Choosing Funds**

- Fees
  - Types
  - Amount
- Past performance (but not a guarantee of future performance)
- Management team
- Customer service
  - Features: Internet access, hours of call center, planning tools, local representatives

For More Information: Mutual Fund Investing: Look at More than the Fund’s Past Performance
[https://www.sec.gov/investor/pubs/mfperform.htm](https://www.sec.gov/investor/pubs/mfperform.htm)

**Fees**

- Sale Loads – one time fee
  - Sales charges
- Ongoing fees
  - Operation costs
  - Marketing fees
  - Shareholder services

**Examples of One-Time Fees**

- Sales Charges
  - No Load
- Load
  - Front load: Sales charge when you purchase fund
  - Back load: Sales charge when you sell
- Redemption fee
- Exchange Fee

**On-Going Fees**

- Account Fee – fee charged for having an account
- Management Fee
- 12b-1 Fee - marketing expenses
- Others – wire transfer, checkwriting, etc.

**Sales Charges vs. Management Expenses**

- The longer you hold an investment:
  - Less effect of sales fee (load)
  - Greater the effect of management expenses
- Your timeline can affect your choice

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Transaction Fees
• Mutual fund pays a fee to brokerage firm to execute its buy and sell orders
• More transactions = greater fees
  – High turnover rate means lots of buying and selling
  – Higher fees
  – Subtracted from the fund’s return

Total Annual Fund Operating Expenses
• Expense ratio
  – Let’s you know how much of the funds assets are going towards annual expenses
  – Expressed as a percentage
  • Expense Ratio = annual expenses ÷ fund assets
• Does not include
  – Loads (sales commissions)
  – Transaction Fees

Expense Ratios
• Good way to compare the ongoing fees of different mutual fund companies
• Example:
  – Company A expense ratio = .75
  – Company B = 1.5

Expense Ratios
• Compare ratios for similar types of fund
  Example:
  – Domestic to domestic
  – International to international
  – Index fund to index fund

Classes of Shares
• Class A (front end loads)
  – Pay commission when you buy the fund
• Class B (back end loads)
  – Pay commission if you sell before the specified period ends. AKA Contingent Deferred Sales Charges
• Class C
  – Carry a level load, collected every year

No Load Funds
• No commission charged
• Purchase directly from the investment company
• Can still charge other fees
  – 12b-1
  – Purchase fees
  – Exchange fees

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An Equal Opportunity Institution
Introduction to Mutual Funds

Getting Started

• Review your options
  – Workplace
  – Individual
• Depending on your comfort level:
  – Get help from a professional
  – Choose your own investments
• Research before choosing

Using a Professional

• What are their credentials?
• Experience level?
• How are they compensated?
  – Fees
  – Commissions
  – Assets under management
• Are you comfortable working with them?

For More Information:
Choosing a Financial Professional from University of Illinois Extension
http://web.extension.illinois.edu/financialpro/index.cfm

Selecting Your Own Funds

• Your financial goals
  – Growth, income, combination
  – Asset allocation
• Available options
  – Employer sponsored plan
  – Individual plans
• Minimum investment to get started
• Read the prospectus

Fund Families

• Advantages
• Disadvantages
• Fund "supermarkets"
  – Allow choices of many families of funds
  – Often also include their own funds

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http://www.finra.org/Investors/ToolsCalculators

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Mutual Funds

- May fit into your investment plan
- Provide diversification
- Understand your personal risk tolerance
- Know your objectives
- Research before purchasing any investment vehicle

Sources & Resources

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Next Month’s Webinar
Comparing Mutual Funds and Exchange Traded Funds
Tuesday, July 29, 12:00 to 1:00 p.m. EDT