



Investment Insights

Kevin Kennedy

The Power of Mutual Funds

According to the Investment Company Institute, over 87 million individuals had invested over \$7.1 trillion in mutual funds as of June of 2000. Mutual funds are a popular investment vehicle in retirement plans, college savings accounts, and individual portfolios. Mutual funds can be a great way for investors to have their assets professionally managed in a diversified portfolio of securities. Here is a brief overview of what mutual funds and how you can use them in your portfolio.

What is a mutual fund? : A mutual fund is an investment company formed to professionally manage the pooled assets of a group of investors. Your investment dollars, along with the money of hundreds or thousands of other investors in the fund, are managed full-time by a fund manager. The fund manager is given the task of researching and selecting the investments he or she thinks offer the greatest potential to meet the objectives of the fund. Many funds are actually managed by a group of managers who share the task of performing research and management of the fund. When you put your money into a mutual fund, you are buying shares in the fund that represent partial ownership in all of the securities owned by the fund. Many of the larger mutual funds have tens of billions of dollars invested in them, so your stake may only be a small percentage of the overall pool. However, whether you have \$1000 or \$1,000,000 in the fund, you share equally in the returns, so if the fund earns a 10% return, each investor sees a 10% increase in their assets.

Why should I consider mutual funds? : One of the lessons learned from the recent Enron debacle is “Don’t put all of your eggs in one basket”. A simple way to avoid this dangerous mistake is to invest in a diversified portfolio of securities so that no single issue represents a large portion of your overall portfolio. Mutual funds accomplish this goal by diversifying your assets among tens or hundreds of stocks or bonds so that if you are unlucky enough to have an Enron in your portfolio, it represents only a small portion of the overall portfolio. Most mutual funds will have less than 5% of the fund invested in any one stock or bond, so that even if that large holding goes down substantially, it won't have a devastating impact on the overall fund. For example, the well-known Fidelity Magellan Fund has over \$79 billion in assets and 258 individual holdings in the fund as of 12/31/01. Thus, the impact of an Enron-type situation in that portfolio would be much less devastating than in a portfolio that only contained three or four other holdings. Whether you have \$1000 or \$1 million to invest, a mutual fund spreads your money out over a large number of holdings, giving you instant diversification.

How do I choose a mutual fund for my situation? : As of December 2001, there were over 13,000 mutual funds operating in the United States. To choose among these thousands of funds, you must first determine what your investment goals are, and then find a fund that invests with your goals in mind. Each mutual fund has a stated objective—i.e. growth, tax-free income, and stability of principal. Each fund also has legal restrictions as to the types of securities they can own in the fund. By reviewing this information, an investor can choose funds best suited to their investment goals. The goals and restrictions of a given fund can be found in the fund's prospectus, which legally outlines all of the operations of the fund, including fees and investment minimums.

A big benefit of mutual funds is professional management. Most of us have full-time careers, hobbies, and family that we prefer to spend our time on. By investing in a mutual fund, we are hiring a professional manager whose full-time job is to oversee our money so we can enjoy the other aspects of our lives. Again, whether you have \$1000 or \$1 million to invest, you can hire these professional to manage your money in a simple and cost effective way by investing in a mutual fund.

For more information about mutual funds, check out Morningstar Inc.'s website at www.morningstar.com. Morningstar has reports and reviews on thousands of mutual funds, along with general information on how to select a fund. You can also request information directly from mutual fund companies, who often have excellent informational booklets and prospectuses they will provide to you at no charge to get you started. You should also consult an investment professional who can help you narrow down your search and focus in on your individual goals and objectives to maximize your chances of having a fun and profitable investing experience.

Kevin Kennedy is president of Kevin Kennedy, LLC, a registered investment advisor firm in Alameda. Reach him at 510-748-1898 or Kevin@KevinKennedyLLC.com. Stocks, bonds, and mutual funds involve risk, including loss of principal. Past performance is no guarantee of future results.