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Mutual Fund Investing For Canadians

FOR DUMMIES®

Learn to:

- Understand your fund options, from equities to indexes to bonds
- Select funds with low expenses and high returns
- Build a fund portfolio that suits your personal investment style
- Protect your money through diversification

Andrew Bell

Host, Business News Network

Matthew Elder

Category	RETURN			Fund
	YTD	3YR	5YR	
Growth	5.73%	10.67%	20.13%	
Value	-6.23	5.31	16.54	
Blend	0.20	5.62	16.15	
Growth	-3.41	7.23	15.78	
Value	-10.09	5.60	14.13	
Value	-19.18	1.56	14.11	1
Value	-14.89	3.21	14.06	
Value	-6.77	6.69	13.62	
Value	-0.81	5.28	13.47	
Value	-2.97	5.80	13.08	
Value	3.82	6.79	12.43	
Value	-5.14	6.28	12.10	
Value	-6.92	7.13	na	
Value	0.07	5.25	na	na

***Mutual Fund Investing
For Canadians***

FOR
DUMMIES®

**by Andrew Bell and
Matthew Elder**



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Introduction

Mutual funds have been a target of criticism over the years. The rap is that their fees are too high, they don't do any better than the market as a whole, and you get sold stuff you don't want — or, worse, stuff that's inappropriate to your financial needs. In some individual cases, those criticisms can be true.

Many funds *are* overpriced; in other words, their annual charges, often used to pay the very people who sell you funds, are too high to allow you to end up with a decent return. Many funds are little better than marketing ploys, and still more just drag their hapless customers through years of lousy returns.

But, despite it all, mutual funds work. And they work well. Conservative funds that invested in quality stocks and bonds — and cautious investors who made sure they didn't risk all their money in stocks — have achieved decent long-term returns. But here's the great part: Picking conservative funds with good returns and putting them together in a smart financial plan isn't that hard or time-consuming. Just follow the simple (and often obvious) guidelines in this book, and you'll do fine.

Life is short and we're all overloaded. So much mud-wrestling, so little time. We've written *Mutual Fund Investing For Canadians For Dummies* as though we're sitting with you in a coffee shop giving you the basic facts on mutual funds and investing — only the essential stuff you need to earn a decent return on your money. We hope you never feel, while reading this book, that we're droning on about something that doesn't affect your life. Most people relegate mutual funds to the grey parking lot of their lives that's reserved for stuff like plumbing or Kansas — something to think about if you have to, but otherwise no thanks. That's a pity; funds really can make a difference in your financial picture.

They aren't very complicated, either — a mutual fund is really just a handy invention that allows hordes of people to pool their cash into a professionally managed investment vehicle that handles the bookkeeping. It then buys things such as shares in companies and bonds issued by governments, things that a lot of ordinary people find confusing. Funds are so powerful and simple that they've helped to transform the economy of the capitalist world.

Until the mass-market mutual fund came along, investing in shares and buying bonds was mostly a privilege of the rich, just like tax evasion and dull conversations about the unreliability of nannies. These days, mutual funds have helped millions of ordinary people, especially in North America, to gather unprecedented wealth.

This book is meant to help you be part of that phenomenon. With a little education, you too can jump on the bandwagon and make yourself some cold, hard cash. Getting up to speed about mutual funds doesn't take long and it can be sinfully profitable. For more and more Canadians — especially the self-employed or those working for small companies — the returns they get from their funds will determine when they can stop working and what kind of retirement income to expect.

How This Book Is Different

Pick up nearly any book or article about investing and you'll probably see a picture of the author — a fresh-faced thing with cute tousled hair or a solemn corrupt senator-type trying to look prosperous. Oh, nothing's more glamorous than the hectic, glittering life of the investment author!

And then every book has its promises: The special formulas, the daring analyses, the hinted-at guarantee that at last you've found the route to riches. But what we all-knowing money gurus rarely get around to explaining is: How come, if we're such fantastic investors, we have to do something as wretched as write a book? Why aren't we striding the trading floor at RBC Dominion Securities, barking orders over a cell phone at quivering central bankers, and restructuring the automobile industry before lunch?

The evidence shows that hardly anybody, including the investment professional, is consistently good at picking shares and bonds that go up in price. Despite all the fancy talk and arcane theories, stock and bond prices move in unpredictable patterns — like the weather or the population of porcupines in New Brunswick.

So yeah, we admit it: This book contains no magic, just some plain logic and simple facts you could find out for yourself by fooling around with mutual funds for a few years. But lots of people don't have the time or inclination to do that — this book is for you, folks.

Besides, the investment market can be an awfully expensive place to learn investing lessons. So read on, and gain the benefit of our (often painful) experiences.

About the Information in This Book

Markets are in a state of constant movement, and the statistics that tell investors how well they're doing change continually. With mutual funds you don't need to keep an eye on their performance quite as closely as you would if you invested in individual stocks, because equity funds are diversified, longer-term investments. However, knowing what your rate of return has been over time, and how that compares to other funds and the relevant benchmark (such as the Standard & Poor's/Toronto Stock Exchange composite index) can be useful. For this reason we include numerous examples of fund performance in this book, using data provided by Morningstar, the world's leading source of investment fund data. This means we had to choose a point in time to capture this data — we selected June 30, 2008, and in most cases we refer to this date as “mid-2008.”

In most cases, we use data for the median mutual fund in a particular category. As we explain in Chapter 2, a *median value* provides a more useful snapshot of a particular group of funds because it represents the midpoint between the highest and lowest values. A simple average, which is frequently used elsewhere to track asset-class performance, is often misleading because the smaller funds in the group have the same impact on the average value as larger funds.

Mutual fund medians exclude the impact of segregated funds, which are the same as mutual funds except they include a guarantee of part or all of your original investment. Segregated funds' higher annual fees (due to the guarantee, which brings with it the extra cost of insurance) can have an unfairly negative impact on a category's median return. (See Chapter 19 for more on seg funds, as they're known.) In some cases where it seems useful to do so, we provide overall median values that include both types of funds.

When describing the size of the Canadian fund industry, in most cases we use total assets data from the Investment Funds Institute of Canada References. However, IFIC's data reflect only the figures supplied by its members, which excludes not only insurance companies' seg funds but also some mutual fund companies, which for one reason or another have decided not to join IFIC. (An important example of the latter is CI Funds, which had more than \$60 billion in mutual fund assets as of mid-2008.) Nonetheless, IFIC's numbers provide an excellent representation of the fund industry's size and activity.

How This Book Is Organized

The best first move is to look at the table of contents to get an idea of what's here. If you already know the basics, just jump to the topics you have trouble with. In the case of subjects with lots of further complications, like official rules and so on, we give you Web addresses so you can do further reading.

Think of the book as being like a set of Russian dolls, nesting inside each other. The smallest doll is Chapter 1, What Is a Mutual Fund? If you're not quite clear on the basics of investing in funds, you can read that chapter and get all the truly important information. It's designed to be a brief primer that gives you the essential core of mutual fund investing. The next level, providing more information on the drawbacks and advantages of funds, is Part I, which was written as a complete introduction to mutual funds. It provides more detail on each topic than we get into in Chapter 1. Then, to explore any aspect of funds in yet more depth, you can simply start jumping around the book. The whole thing is pretty flexible.

So don't worry about reading every chapter. You should be out partying anyway. Jump right to the section you're interested in, because each is understandable without reading others first. Throughout the book, we've avoided jargon wherever possible — where we're forced to use a technical term, we explain it right away.

The sections that follow describe the parts in this book and what they cover.

Part I: Meet the Mutual Fund

This first section is a summary of how funds work and the reasons to buy them, as well as what type to buy. Packed with definitions and plain-English explanations, this part is built for the novices who have been left scratching their heads about fund basics. You need to get your financial house in order before diving into the fund pool, so this part also features a crash course on financial planning and much, much more.

Part II: Buying Options: Looking for a Helping Hand

In Part II we walk through all the possible sources of help you might consider, from your friendly neighbourhood bank to a discount broker. Packed with inside information about who does what, this part will help you figure out exactly what you're looking for in terms of financial advice, and how much that advice should set you back.

Part III: The Fund Stuff: Building a Strong Portfolio

Herein lies the industry's entire menu of funds, give or take a handful. These days funds exist for every type of investor, from the daredevil who would just as soon go to the racetrack to the notorious mattress stuffer who can't part with a single dime. This part runs through the many fund types and helps you match your financial goals to what these beasts have to offer. All the biggies are here — equity funds, money market funds, and index funds, plus a look at fund packages. Each chapter includes suggestions for winning funds, prepared for this book by analysts at Morningstar, the country's leading mutual fund research firm.

Part IV: The Nuts and Bolts of Keeping Your Portfolio Going

Getting started in funds may seem like the hard part, but keeping your portfolio humming along and turning a profit is a challenge all its own. In this part we offer some valuable advice on tracking your progress and optimizing the mighty combination of your registered retirement savings plan and mutual funds. We also take a long hard look at taxes and your funds.

Part V: The Part of Tens

The Part of Tens is a collection of quick factoids about funds. We list ten common investing foul-ups in funds, which we hope you'll find entertaining as well as disturbing. We also list ten things to consider when hiring a salesperson — and a to-do list to consult if you're wondering whether to dump one.

Icons Used in This Book

Ever go over one of those speed bumps — the British call them “sleeping policemen” — at full throttle? Catches your attention. This finance stuff can get heavy after the 200th page. So, to keep you alert, throughout the book we sprinkle icons in the margin to wake you up and highlight important information that's too good to miss. It might be a grim admonition, a neat piece of advice, or a nugget of wisdom. Here's what to look out for.



This icon — judiciously used — denotes a product or particular fund that does a good job and offers you benefits. But watch out — funds have an annoying habit of dropping to the bottom of the performance table right after writers recommend them. In part that’s because the type of investments the fund buys have already shot up in value.



Remember icons flag an important piece of information that’s like the crucial clue in an Agatha Christie novel. The bit where the jealous sister-in-law couldn’t possibly have heard the 1 a.m. time check on the radio when she said she did — *because the clocks went forward that night*. Our turning points won’t be so complicated. They’re simply realities about mutual funds that are worth always bearing in mind.



Relax: You can get away without reading this stuff. But for those who like a good conspiracy story, this icon denotes interesting, if not throwaway, information. It flags a place where we talk about the internal workings of a fund. But you can invest in funds perfectly well without reading it. In practice, Technical Stuff usually involves the money that fund managers and salespeople get from the funds they market. That’s the thing that kind of drives the whole show forward.



The Tip icons point to methods or suggestions that save you money, improve your returns, or reduce your risk. They’re also quick-and-dirty shortcuts. Or they mark practicalities that fund companies may not mention.



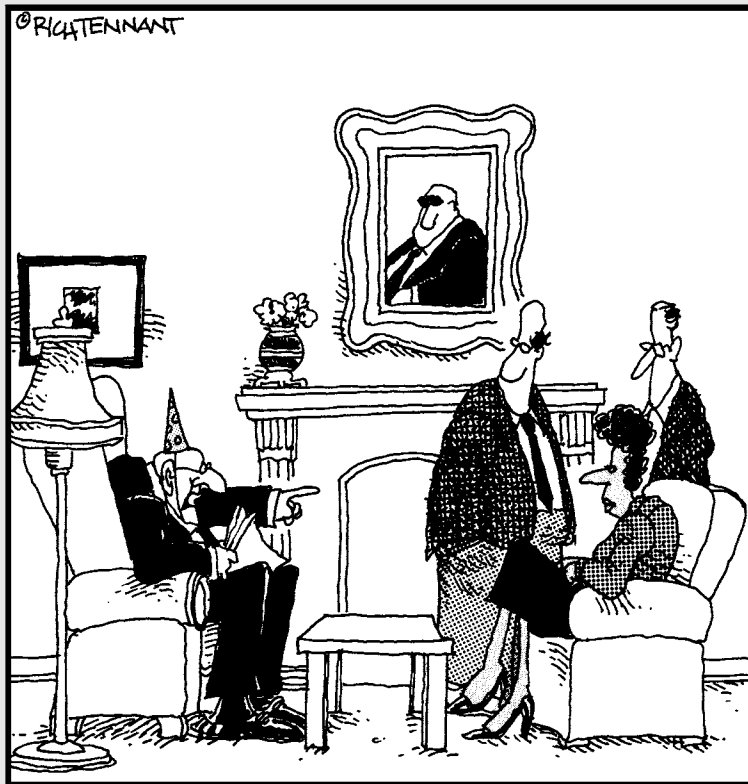
Warning icons flag a dangerous reef that you have to skirt — something that could cost you lots of money, either by hitting you with excessive management and sales fees, by leaving you vulnerable to nasty losses, or by dragging down your overall returns.

Part I

Meet the Mutual Fund

The 5th Wave

By Rich Tennant



"Choosing the right mutual fund is like choosing the right hat. You find one that fits you best and then you stick with it."

In this part . . .

Here's all you need to build a perfectly good mutual fund portfolio. We explain why you should own at least some funds. We also describe how funds work and set out the basic mechanics of buying funds and using them to make money. We also look at how funds fit beautifully into just about everyone's financial plan, and show you some of the alternative investments you can buy.

Chapter 1

What Is a Mutual Fund?

In This Chapter

- ▶ Understanding mutual funds
 - ▶ Looking at how funds can make you money
 - ▶ Identifying the four types of mutual funds
 - ▶ Knowing where to buy funds
-

Unless you've been living in a cave high in the mountains for the past decade, railing against the evils of humankind, you've heard a lot about mutual funds. Chances are you or someone in your family already owns some. Mutual funds seem complicated — even though they are incredibly popular — so lots of people shy away. Many people aren't sure where to start, or they just buy the first fund their banker or financial planner suggests. All too often Canadians end up disappointed with their funds' performance, because they've been sold something that's either unsuitable or just too expensive. It's a shame, because building a portfolio of excellent funds is easy if you follow a few simple rules and use your own common sense. This stuff isn't complicated — a mutual fund is just a money-management service that operates under clear rules. Yes, it involves a lot of marketing mumbo-jumbo and arcane terminology, but the basic idea could be written on a postage stamp: In return for a fee, the people running the fund promise to invest your money wisely and give it back to you on demand.

The fund industry is competitive and sophisticated, which means plenty of good choices are out there. In this chapter, we show how funds make you money — especially if you leave your investment in place for several years. We also touch on the different types available, and quickly describe the main places you can go to buy funds. We discuss these topics in greater detail later in the book, but after you read this first chapter you'll know the basics.

Mutual Fund Basics



A mutual fund is a pool of money that a company gets from investors like you and me and divides up into equally priced units. Each unit is a tiny slice of the fund. When you put money into the fund or take it out again, you either buy or sell units. For example, say a fund has total assets — that is, money held in trust for investors — of \$10 million and investors have been sold a total of 1 million units. Then each unit is worth \$10. If you put money into the fund, you're simply sold units at that day's value. If you take money out, the fund buys units back from you at the same price. (Handling purchase and sale transactions in units makes it far simpler to do the paperwork.) And the system has another huge advantage: As long as you know how many units you own, you can simply check their current price to find out how much your total investment is worth. For example, if you hold 475 units of a fund whose current unit price is \$15.20, then you know your holding has a value of 475 times \$15.20, or \$7,220.



Owning units of a mutual fund makes you — you guessed it — a unitholder. In fact, you and the other unitholders are the legal owners of the fund. But the fund is run by a company that's legally known as the fund manager — the firm that handles the investing and also deals with the fund's administration. The terminology gets confusing here because the person (usually an employee of the fund manager) who chooses which stocks, bonds, or other investments the fund should buy is also usually called the fund manager. To make things clear, we refer to the company that sells and administers the fund as the management company or fund sponsor. We use the term fund manager for the person who picks the stocks and bonds. His or her skill is one of the main benefits you get from a mutual fund. Obviously, the fund manager should be experienced and not too reckless — after all, you're trusting him or her with your money.

Under professional management, the fund invests in stocks and bonds, increasing the pool of money for the investors and boosting the value of the individual units. For example, if you bought units at \$10 each and the fund manager managed to pick investments that doubled in value, your units would grow to \$20. In return, the management company slices off fees and expenses. (In the world of mutual funds, just like almost everywhere else, you don't get something for nothing.) Fees and expenses usually come to between 0.3 percent and 3 percent of the fund's assets each year, depending on how a fund invests. Some specialized funds charge much more.

Confused? Don't be, it isn't rocket science. This example should help. Units in Canada's biggest mutual fund, Investors Dividend Fund — run by the country's largest fund company, Investors Group — were bought from and sold to people like you and me at \$21.83 each at the end of March 2008. So if you