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7th Edition

# Mutual Funds

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*Bestselling author, Personal Finance For Dummies and Investing For Dummies*



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# Introduction

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**W**hether you're a regular reader of investing books or this is your first, *Mutual Funds For Dummies*, 7th Edition, which is completely revised and updated, provides practical and profitable techniques of fund investing that you can put to work now and for many years to come.

Funds aren't literally for dummies — in fact, they're a wise investment choice for people from all walks of life. Mutual funds are investment companies that combine your money with that from many other people to create a large pool of assets that can be invested in stocks, bonds, or other securities. This book also extensively covers exchange-traded funds, which are like mutual funds except that they trade on a stock exchange when the financial markets are open. Because your assets are part of a much larger whole, the best funds enable you to invest in securities that give you low-cost access to leading professional money managers.

With the best money managers investing your nest egg in top-flight investments that match your financial goals, you can spend your time doing the activities in life that you enjoy and are best at. Funds should improve your investment returns as well as your social life!

I practice what I preach. All my investments that I've devoted to securities (stocks and bonds) are invested through funds. Why? For the simple reason that I'm confident the best fund managers that I recommend in this book can do a superior job (higher returns, less cost) than I can by researching and selecting individual stocks and bonds on my own.

I've enjoyed successfully investing in funds for more than 30 years. As a financial counselor, writer, and lecturer, I've helped investors make informed investing decisions with mutual funds as part of comprehensive personal financial management. So I know the questions and challenges that you face when you invest in funds. I wrote this book to answer your fund-investing questions in plain English.

# What's New in This Edition

Life and the investment world change. Although the essence of what makes mutual funds worthy of your investment dollars hasn't changed since the last edition of this book was published several years ago, the fund industry has certainly seen new developments. In this newly updated seventh edition, here are the major issues:

- » Alternatives to mutual funds — growth of exchange-traded funds, shake-out in hedge funds, researching your own stocks and bonds, and creating your own fund, private money managers, closed-end funds, and so on
- » Opportunities and pitfalls investing in funds online with expanded and updated coverage of robo-advisors, websites, and software
- » New tax laws and their impact on smart fund-investing strategies
- » Updates to the funds and resources that I recommend

# How This Book Is Different

Many investment books confuse folks. They present you with some newfangled system that you never figure out how to use without the help of mathematicians and a Nobel laureate as your personal tutors. Books that bewilder more than enlighten may be intentional because the author may have another agenda: to get you to turn your money over to him to manage or to sell you his pricey newsletter(s). Writers with an agenda may imply — and sometimes say — that you really can't invest well, at least not without what they're selling.

Going another route, too many investment books glorify rather than advise. They place on a pedestal the elite few who, during decidedly brief periods in the history of the world and financial markets, managed to beat the market averages by a few percentage points or so per year. Many of these books (and their publishers) suggest that reading them shows you the strategies that led Superstar Money Manager of the Moment to the superlative performance that the book glorifies. "He did it his way; now you can, too," trumpets the marketing material. Not so. Reading a book about what made LeBron James a phenomenal basketball player or Shakespeare a great playwright won't help you shoot a basketball or versify like these famous folks. By the same token, you can't discover from a book the way to become the next Wall Street investment wizard.

*Mutual Funds For Dummies*, 7th Edition, helps you avoid fund-investing pitfalls and maximizes your chances for success. When you want to buy or sell a fund, your decision needs to fit your overall financial objectives and individual situation. Fund investors make many mistakes in this regard. For example, they invest in funds that don't fit their tax situation.

This book also covers pesky issues completely ignored by other fund books. For novice fund investors, simply finding and completing the correct application in the blizzard of forms that fund companies offer can be a challenge. And if you invest in funds outside of tax-sheltered retirement accounts, you're greeted by the inevitable headache from figuring out how to report distributions at tax time. This book puts you on the right path to avoid these problems.

The truth is, investing isn't all that difficult — and funds are the great equalizer. There's absolutely no reason, except perhaps a lack of time and effort on your part, why you can't successfully invest in mutual funds and exchange-traded funds. In fact, if you understand some basic concepts and find out how to avoid major mistakes that occur for some fairly obvious reasons, you can be even more successful than most so-called investment professionals.

## Foolish Assumptions

Whenever an author sits down to write a book, he has to make some assumptions about his audience, and I've made a few that may apply to you:

- » You're looking for sensible investments.
- » You've done some research (or perhaps thought about doing some) on mutual funds and found the thousands of fund choices to be a bit daunting.
- » Your investment portfolio contains or has contained funds, and you're looking for up-to-date information on how changes in the economy and financial markets can affect the decisions you make.

If one or more of these descriptions rings true, you're in the right place. Mutual funds are a huge business, and they can be confusing. Today, thousands of mutual funds account for more than \$15 trillion under management, and exchange-traded funds hold another \$2 trillion. Although the basic principle behind funds sounds simple enough — pooled money from many individuals that's invested in stocks, bonds, or other securities — you have to understand the different types of investments, such as stocks and bonds, and the way they work.

Unfortunately, you have too many individual funds from which to choose — hundreds of fund companies, brokerage firms, insurers, banks, and so on are selling thousands of funds. Even experienced investors suffer from information overload. Luckily for you, I present short lists of great funds that meet different needs.

And because no investment, not even one of the better funds, is free of flaws and shortcomings, I explain how to avoid the worst funds — and the numerous mediocre ones — that clutter the investment landscape. I also help you understand when investing in funds may not be appropriate for you and what your best options may be.

## Icons Used in This Book

Throughout this book, you can find friendly and useful icons that enhance your reading pleasure and flag special types of information. So when you meet one of these margin-hugging doodads, consider the following:



TIP

This icon points out something that can save you time, headaches, money, or all the above!



WARNING

The warning icon helps steer you away from mistakes and boo-boos that others have made when investing in funds. *Something* here could cost you big bucks if you don't devote your attention to these icons.



ERIC'S PICKS

This icon denotes my favorite mutual funds and exchange-traded funds.



TECHNICAL STUFF

Eminently skippable stuff here, but if you don't read it, you may not seem as astute at the next cocktail party when fund trivia games begin. Neat but non-essential stuff — read at your leisure.



INVESTIGATE

I've told you as much as I can, but you may need or want to check it out more on your own before you make a move.



REMEMBER

This icon designates something important that I want you to *make sure* you don't forget when you're making your own fund-investing decisions!



## Beyond the Book

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In addition to what you're reading right now, this product also comes with a free access-anywhere Cheat Sheet that can help you think about the role of fund investing in your personal and financial life. To get this Cheat Sheet, simply go to [www.dummies.com](http://www.dummies.com) and search for “*Mutual Funds For Dummies* Cheat Sheet” in the Search box.

## Where to Go from Here

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You don't need to read this book cover to cover. But if you're a beginner or you want to fully immerse yourself in the world of fund investing, go for it! However, you may have some specific questions today, and you'll want some other information tomorrow. No problem there, either. *Mutual Funds For Dummies*, 7th Edition, is well organized and easier to use than other fund-investing books. Use the table of contents or the index to speed your way toward what you need to know and get on with your life.



# 1

## **Getting Started with Funds**

**IN THIS PART . . .**

Understand investment options, risks, rewards, and diversification.

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Discover the pros and cons of mutual and exchange-traded funds.

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Get your financial house in order before investing in funds.

## IN THIS CHAPTER

Defining mutual funds and exchange-traded funds

Understanding investments

Weighing your options

Seeing the big picture: Returns, risks, and risk reduction

# Chapter 1

# Making More Money, Taking Less Risk

In my years of work as a financial adviser and a columnist answering many readers' questions, I've seen the same, avoidable mistakes being made over and over. Often, these investing mistakes occurred for one simple reason: a lack of investment understanding. People didn't know what their investing options were and why particular options were inferior or superior to others.

By reading this book, you can prevent yourself from making investment mistakes. And you can take advantage of an excellent investment vehicle: mutual funds — the best of which offer you diversification, which reduces your risks, and low-cost access to highly diversified portfolios and professional money managers, who can boost your returns with less risk. Mutual funds and exchange-traded funds can fit nicely in the context of your overall financial plans and goals. This chapter gives you an investment overview so you can see how mutual funds and exchange-traded funds fit into the overall investment world.

# Introducing Mutual Funds and Exchange-Traded Funds

If you already understand stocks and bonds, their risks and potential returns, and the benefits of diversification, terrific. You can skip this chapter. Most people, however, don't really comprehend investment basics, which is one of the major reasons people make investment mistakes in the first place.

After you understand the specific types of securities (stocks, bonds, and so on) that funds can invest in, you've mastered one of the important building blocks to understanding mutual funds. A *mutual fund* is a vehicle that holds other investments: When you invest in a mutual fund, you're contributing to a big pool of money that a mutual fund manager uses to buy other investments, such as stocks, bonds, and/or other assets that meet the fund's investment objectives.

Exchange-traded funds (ETFs) are a very close relative of mutual funds and differ from them in one particular way. ETFs trade like stocks on a stock exchange and thus can be bought or sold during the trading day when the financial markets are open. (In Chapter 2, I explain one exception to this rule. A type of mutual fund, known as a closed-end fund, trades on a stock exchange during the trading day and has a fixed number of shares outstanding.)

Differences in investment objectives are how funds broadly categorize themselves, like the way an automaker labels a car a *sedan* or a *sport utility vehicle*. This label helps you, the buyer, have a general picture of the product even before you see the specifics. On the dealer's lot, the salespeople take for granted that you know what *sedan* and *sport utility vehicle* mean. But what if the salesperson asks you whether you want a Pegasus or a Stegosaurus? If you don't know what those names mean, how can you decide?

Fund terms, such as *municipal bond fund* or *small-cap stock fund*, are thrown around casually. Fact is, thanks to our spending-oriented culture, the average American knows car models better than types of funds! In this chapter (and in Chapter 2), I explain the investment and fund terms and concepts that many writers assume you already know (or perhaps that they don't understand well enough themselves to explain to you). But don't take the plunge into funds until you determine your overall financial needs and goals.