

Making Everything Easier!™

6th Edition

# Mutual Funds

FOR

# DUMMIES®

## Learn to:

- Plan and implement a successful investment strategy that includes mutual funds
- Find the best-managed funds that match your financial goals
- Avoid fund-investing pitfalls
- Select among mutual funds, exchange-traded funds (ETFs), and other investing options

**Eric Tyson**

*Bestselling author, Investing For Dummies*



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# *Mutual Funds For Dummies*<sup>®</sup>

by **Eric Tyson, MBA**



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## About the Author

**Eric Tyson, MBA**, is a bestselling author and syndicated columnist. Through his counseling, writing, and teaching, he teaches people to manage their personal finances better and successfully

direct their own investments.

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He has been involved in the investing markets in many capacities for the past two decades. Eric first invested in mutual funds back in the mid-1970s, when he opened a mutual fund account at Fidelity. With the assistance of Dr. Martin Zweig, a now-famous investment market analyst and frequent guest on PBS's Wall Street Week, Eric won his high school's science fair for a project on what influences the stock market!

Since that time, Eric has (among other things) worked as a management consultant to Fortune 500 financial service firms and earned his bachelor's degree in economics at Yale and an MBA at the Stanford Graduate School of Business. Despite these handicaps to clear thinking, he had the good sense to start his own company, which took an innovative approach to teaching people of all economic means about investing and money.

An accomplished freelance personal finance writer, Eric is the author of the national bestsellers *Personal Finance For Dummies* and *Investing For Dummies* and coauthor of *Home Buying For Dummies* and *Taxes For Dummies* and was an award-winning columnist for the San Francisco Examiner. His work has been featured and quoted in dozens of national and local publications, including Newsweek, The Wall Street Journal, Forbes, Kiplinger's Personal Finance Magazine, the Los Angeles Times, and Bottom Line/Personal, and on NBC's Today Show, ABC, CNBC, PBS's Nightly Business Report, CNN, CBS national radio, Bloomberg Business Radio, and Business Radio Network. He's also been a featured speaker at a White House conference on retirement planning.

Despite his "wealth" of financial knowledge, Eric is one of the rest of us. He maintains a large inventory of bumble-bee colored computer books on his desk for those frequent times when his computer makes the (decreasing amount of) hair on his head fall out.

Eric's Web site is [www.erictyson.com](http://www.erictyson.com).

## Dedication

To my wife, Judy; my family — especially my parents, Charles and Paulina; my friends; and to my counseling clients and students of my courses for teaching me how to teach them about managing their finances.

## Author's Acknowledgments

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~~The technical reviewer for this edition of the book was Mercer Bullard. He helped to improve each and every chapter, and I am thankful for that.~~

Thanks to all the good people in the media and other fields who have taken the time to critique and praise my previous writing so that others may know that it exists and is worth reading. And to those too lazy to open the book just because of its bright yellow color and title, I say, “Don’t judge a book by its cover!”

And a final and heartfelt thanks to all the people on the front lines and behind the scenes at Wiley who helped to make this book and my others a success. A big round of applause, please, for Kelly Ewing as project editor and as outstanding copy editor. Special thanks to Mike Baker. Thanks also to the Composition, Graphics, Proofreading, and Indexing staff for their great efforts in producing this book.

P.S. Thanks to you, dear reader, for buying my books.

## **Publisher’s Acknowledgments**

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# Introduction

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Whether you're a regular reader of investing books or this is your first, *Mutual Funds For Dummies*, 6th Edition, which is completely revised and updated, provides practical and profitable techniques of mutual fund investing that you can put to work now and for many years to come.

Mutual 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. Because your assets are part of a much larger whole, the best mutual 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. Mutual 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 could by researching and selecting individual stocks and bonds on my own.

I've enjoyed successfully investing in mutual funds for more than 25 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, in plain English, your fund-investing questions.

## 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 sixth edition, here are the major issues:

- Coverage of the 2008–09 global stock market panic and how funds and fund investors fared and what can be learned from that experience

- 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

- Increasing numbers of specialized funds, such as those investing in gold, real estate, market-neutral funds, and so on

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 Kobe Bryant a phenomenal basketball player or Shakespeare a great playwright won't help you shoot a basket 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*, 6th Edition, helps you avoid fund-investing pitfalls and maximizes your chances for success. When you want to buy or sell a mutual 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 mutual 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 mutual 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 in order to avoid these problems.

The truth is, investing isn't all that difficult — and funds are the great equalizer. There's absolute no reason, except perhaps a lack of time and effort on your part, why you can't successfully invest in mutual 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

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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 mutual 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 \$11 *trillion* under management. Although the basic principle behind mutual 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 mutual fund companies, brokerage firms, insurers, banks, and so on are selling thousands of funds. Even experienced investors suffer from information overload. Lucky for you, I present short lists of great funds that meet different needs.

And because no investment, not even one of the better mutual 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.

## How This Book Is Organized

The sections that follow contain a preview, of sorts, of the various sections in this book and what they cover.

### **Part I: Mutual Funds: Sharing Risks and Rewards**

Part I defines and demystifies what mutual funds are and discusses what they're good for. Before you're even ready to start investing in funds, your personal finances need to be in order, so I give you some financial housecleaning tips. You can also discover the importance of fitting mutual funds to your financial goals. Part I also covers how to pick great funds, how to avoid loser funds, where and how to purchase funds, and how to read all those pesky reports that fund companies tend

to produce.

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## **Part II: Evaluating Alternatives to Funds**

Mutual funds are hardly the only game in town for those folks seeking someone to manage their money. In recent years, exchange-traded funds and hedge funds, for example, have been pitched to many investors. Other investors believe that they can be their own best stock and bond pickers. This part discusses all the fund-investing alternatives and more to help you select which option(s) are best for your situation.

## **Part III: Separating the Best from the Rest**

This part explains what makes a fund and fund company worth investing in. You see how to read and understand common fund documents. I also explain the best venues and avenues for buying funds and help you think through whether to enlist the services of an adviser.

## **Part IV: Crafting Your Fund Portfolio**

This part shows you how to build a portfolio that includes mutual funds to accomplish your specific financial goals. You start off by exploring the basic strategies of portfolio construction. Then for each of the major fund types — money market, bond, and stock — you get specific fund recommendations. I also discuss specialty funds. A chapter of sample fund portfolios based on real-life scenarios brings together the important concepts in this section. Last but not least, I cover how to complete the often-pesky paperwork funds demand of you.

## **Part V: Keeping Current and Informed**

After you have a good fund portfolio up and running, you shouldn't have to devote much time to maintaining it. This part covers what you do need to do, including chapters on how to evaluate your funds' performance and deal with the tax issues that come up on your investments. I also offer some tips on how to minimize aggravations when you deal with fund companies and discount brokers.

If you're still not satisfied, you can find out about the scores of individuals, companies, and publications that rank and predict financial market gyrations. I warn you about the bad ones and the dangers of blindly following gurus, and I reveal which, if any, of them really are gurus. You also discover how to use the best mutual fund information sources, how to tell the difference between good and bad newsletters, and where to turn for more information. You may want to know how to use your computer to track and even invest in mutual funds online — so this part tells you how to do that, too.


# Part VI: The Part of Tens


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Broaden your thinking with these chapters that offer ten or more ideas about important fund issues and concepts. I discuss common fund-investing mistakes made by investors, ease some fund-investing fears that you may have, and cover issues to consider before hiring an adviser. In the appendix, you find the contact information for all the top-notch funds I recommend.

## 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:


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


 The warning icon helps steer you away from mistakes and boo-boos that others have made when investing in mutual funds.

 *Something* around here could really cost you big bucks (maybe even an arm and a leg!) if you don't devote your attention to these icons.

 This icon denotes Eric's favorite mutual funds.

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

 Eric's told me as much as he can, but he thinks that I may need or want to check it out more on my own before I make a move.

 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!

# 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*, 6th 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.

# Part I

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## Mutual Funds: Sharing Risks and Rewards



### In this part . . .

This part gives you an excellent grounding in the fundamentals of mutual fund investing. You also find out how to fit mutual funds neatly with the rest of your finances, and you get an inside look at how and when to invest in the best mutual funds.



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