UNDERSTANDING MUTUAL FUNDS

What Is a Mutual Fund?

A mutual fund is an actively managed investment company that pools money from individuals and institutions, which share a common financial goal. Professional money managers build a portfolio of securities they believe will help investors achieve their objectives. Portfolios typically consist of stocks, bonds and money market instruments, or a combination of these investments.

Investors buy shares of the mutual fund, each share representing proportional ownership in all of the fund's underlying securities. The net asset value (NAV), is determined at the end of each business day by adding up the value of all the securities in the fund's portfolio, after expenses, and dividing the sum by the total number of outstanding shares.

Most mutual funds are "open-end," meaning the funds sell as many shares as investors want to buy. Investors may buy or sell shares from the fund each business day. There are also "closed-end" funds, which typically have only a one-time offering of a fixed number of shares and are usually traded on an exchange or in the over-the-counter market.

Front-end, and in some cases back-end, sales loads, management fees, Rule 12b-1 fees and other expenses are associated with mutual fund investments. Investment returns for a fund take into account these fees and expenses. The funds are offered through prospectuses, which contain detailed information about a fund's sales charges, expenses and risks. They should be read carefully before investing.

Mutual Fund Advantages

Four attributes of mutual funds can work to your advantage:

1. Diversification

By pooling investors' money, a mutual fund may purchase securities from many, often hundreds, of different issuers, dramatically reducing the risk that problems or losses in any one company will hurt the overall portfolio. It would be difficult for most investors to match this level of diversification on their own.

2. Professional Management

Professional money managers make buy and sell decisions based on extensive research on sectors, industries and individual companies, combined with analysis of economic and market trends. Few individual investors have the time or the resources to manage a sizable portfolio on a daily basis or stay current on the thousands of securities available in financial markets.

3. Liquidity

You may sell some or all of your mutual fund shares at any time and receive the current value of your shares (net asset value), which may be more or less than the original cost. In some cases, a sales charge may apply.

4. Convenience

Mutual funds offer shareholders many services that make investing easier. You can usually:

- Exchange money between funds within the same fund family as your investment objectives change.*
- Add to your account electronically, for example, by transferring a set dollar amount from your savings or checking account into your mutual fund account each month.
- Choose to have distributions of fund income paid to you by check, transferred into your bank account or automatically reinvested in more shares of the fund.
- Buy or sell shares by telephone or online.

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Asset Allocation: Creating a Customer Mix

Asset allocation, or the strategy of divvying up your assets among stock, bond and cash investments, optimizes the balance between the amount of risk you want to take and the returns you need to meet your long-term financial objectives.

Mutual funds provide one of the most convenient ways of diversifying your assets among the three different asset classes. By using asset allocation with the help of a professional financial advisor, you can tailor a portfolio to your investment objectives, time horizon, feelings about risk and current financial circumstances.

Three Basic Ingredients

Most mutual funds invest in one or more of the three major financial asset classes:

STOCKS

Stocks represent part ownership, or equity, in a company. Most investors buy stock because they expect the company to make a profit, which in turn will increase the value of its stock. However, a stock's value can change at any moment, depending on market conditions, investors' perceptions and a host of other issues. While stock prices historically have been more volatile than prices of either bonds or money market instruments, they have produced the highest returns over the long term.[**]

BONDS

Bonds are IOUs, or debt, issued by a corporation, government or government agency in exchange for an investor's loan. The bond issuer promises to repay the principal amount of the loan on a certain date, and to make periodic, fixed-interest payments in the interim, which is why they're called "fixed income" investments. A bond's value is determined by the interest it pays and what's happening in the economy. It fluctuates along with interest rates. When interest rates decline, the value of existing bonds (paying a higher interest rate) typically rises. When rates increase, the value of existing bonds usually falls. Changes in the credit quality of a bond or perceived changes in the financial condition of the issuer may also impact a bond's value.

MONEY MARKET INSTRUMENTS

Money market instruments are short-term debt securities issued by governments, corporations, banks or other financial institutions. They typically must be repaid within one year, often in 90 days or less. With such short maturity periods, prices of money market instruments are generally more stable than prices of long-term debt securities. However, money market securities usually pay less interest than long-term bonds. U.S. Treasury bills and certificates of deposit (CDs) are two commonly issued money market instruments.

The Investment Advice You Need

People's Financial Advisors can develop an investment plan to help you reach your financial objectives. If you would like to schedule an appointment with one of our Financial Advisors call us at **1-800-392-3009.**

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[*]Certain funds offer multiple share classes, subject to different fees and expenses. Certain exceptions and restrictions apply to exchange programs, as stated in the prospectuses, and it may be modified or discontinued by the fund(s). Exchanges between funds within a family, while incurring no additional transaction fee, may nevertheless result in a taxable event.
[**]Sources: Standard & Poor's Micropal, Lehman Brothers, Lipper Inc. and Standard & Poor's.

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