Sound Mind Investing

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20 Major Advantages of Investing in Mutual Funds

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In this article, I want to talk about why mutual funds should play an important role in your financial future. They offer many benefits that'll make your investing program easier and safer.

Here are 20 advantages of investing in mutual funds.

Advantage #1: Mutual funds can reduce the anxiety of investing.

Most investors constantly live with a certain amount of anxiety and fear about their investments because they feel they lack one or more of the following essentials: (1) market knowledge, (2) investing experience, (3) self-discipline, (4) a proven game plan, or (5) time. As a result, they often invest on impulse or emotion. Because of their inherent design that taps professional expertise and spreads risk, mutual funds can go a long way toward relieving the anxiety associated with investing.

Advantage #2: Mutual fund shares can be purchased in such small amounts, so it's easy to get started.

If you have been putting off starting your investing program because you don't know which stocks to invest in (and you can't afford your own personal investment consultant!), mutual funds will get you on your way. Investing in a mutual fund usually doesn’t require a large sum of money. Most fund organizations *do* have minimum amounts needed to open an account (usually $1,000 to $3,000), but minimums are often dramatically lower for IRAs and for "automatic deposit accounts" (where you agree to make regular monthly deposits to build your account).

Advantage #3: Mutual fund accounts can be added to whenever you want (often or seldom) — and in small amounts.

After meeting the initial minimum to open your account, you can add just about any amount you want. To make your purchase work out evenly, mutual funds sell "fractional" shares. For example, if you invest $100 in a

fund selling at $7.42 a share, the fund organization will credit your account with 13.477 shares ($100.00 divided by $7.42 = 13.477).

Advantage #4: Mutual funds reduce risk through diversification.

Stock funds typically hold from 50 to 500 stocks in their portfolios; the average is around 100. They do this so that any loss caused by the unexpected collapse of any one stock will have only a relatively minor effect on the pool as a whole. Without the availability of mutual funds, the investor with just $2,000 to invest would likely put it all in just one or two stocks (a risky way to go). But by using a mutual fund, that same $2,000 can make the investor a part owner in a large, professionally researched and managed portfolio of stocks.

Advantage #5: Price movements of mutual funds are more predictable than those of individual stocks.

Their extensive diversification, coupled with outstanding stock selection, makes it highly unlikely that the overall market will move up without carrying almost all stock mutual funds up with it. For example, on Sept. 8, 2008, a day when the Dow jumped 290 points, more than 95% of stock mutual funds were up for the day. Yet, of the more than 3,200 individual stocks that traded on the New York Stock Exchange, only 63% ended the day with a gain. The rest ended the day unchanged (2%) or actually fell in price (35%).

Advantage #6: The past performance of mutual funds is a matter of public record.

Advisory services, financial planners, and stockbrokers have records of past performance, but how public are they? And how were they computed? Did they include every recommendation made for every account? Mutual funds have fully disclosed performance histories, which are computed according to set standards. With a little research, you can learn exactly how various mutual funds fared in relation to inflation or other investment alternatives.

Advantage #7: Mutual funds provide full-time professional management.

Highly trained investment specialists are hired to make the decisions as to which stocks to buy. The person with the ultimate decision-making authority is called the portfolio manager. The manager possesses expertise in many financial areas, and hopefully has learned — through experience — to avoid the common mistakes of the amateur investor. Most important, the manager is expected to have the self-discipline necessary to doggedly stick with the mutual fund’s strategy even when events move against him for a time.

Advantage #8: Mutual funds allow you to efficiently reinvest your dividends.

If you were to spread $5,000 among five different stocks, your quarterly dividend checks might amount to $10 from each one. It's not possible to use such a small amount to buy more shares without paying very high relative commissions. Your mutual fund, however, will gladly reinvest any size dividends for you *automatically*. This can add significantly to your profits over several years.

Advantage #9: Mutual funds offer you automatic withdrawal plans.

Most funds let you sell your shares automatically in an amount and frequency of your choosing. This pre-planned selling enables the fund to mail you a check for a specified amount monthly or quarterly. This allows investors in stock funds that pay little or no dividends to receive periodic cash flow.

Advantage #10: Mutual funds provide you with individual attention.

It has been estimated that the average broker needs 400 accounts to make a living. How does he spread his time among those accounts? The common-sense way would be to start with the largest accounts and work his way down. Where would that leave your $2,000 account? But in a mutual fund, the smallest member of the pool gets exactly the same attention as the largest because everybody is in it together.

Advantage #11: Mutual funds can be used for your IRA and other retirement plans.

Mutual funds offer accounts that can be used for IRAs and 401(k) plans. They’re especially useful for rollovers (which is when you take a lump sum payment from an employer's pension plan because of your retirement or termination of employment and must deposit it into an IRA investment plan account within 60 days). The new IRA rollover account can be opened at a bank, mutual fund, or brokerage house and the money then invested in stocks, bonds, or money market securities. These rollover accounts make it possible for you to transfer your pension benefits to an account under your control while protecting their tax-deferred status. They are also useful for combining several small IRAs into one large one.

Advantage #12: Mutual funds allow you to sell part or all of your shares at any time and get your money quickly.

By regulation, all open-end mutual funds must redeem (buy back) their shares at their net asset value whenever you wish. It's usually as simple as a toll-free phone call. Of course, the amount you get back will be more or less

than you initially put in, depending on how well the stocks in the portfolio have done during the time you were a part owner of the pool.

Advantage #13: Mutual funds enable you to instantly reduce the risk in your portfolio with just a phone call.

Most large fund organizations (usually referred to as "families") allow investors to switch from one of their funds to another via a phone call or over the Web and at no cost. One practical use of this feature is that is makes it easy to reallocate your capital between funds that invest in different types of asset classes (large-company growth, large-company value, small-company growth, small-company value, foreign stocks, and fixed-income securities) as your goals and market expectations evolve.

Advantage #14: Mutual funds pay minimum commissions when buying and selling for the pool.

They buy stocks in such large quantities that they always qualify for the lowest brokerage commissions available. An average purchase of stock can easily cost the small investor 2%-4% in commissions to buy and sell (depending on broker, dollar size of order, and number of shares). On the other hand, the cost is a mere fraction of 1% on a large purchase like $100,000. Many investors would show gains rather than losses if they could save almost 3% on every trade! The mutual-fund pool enjoys the savings from these massive volume discounts, enhancing the profitability of the pool. Eventually, then, part of that savings is yours. (These commission savings, however, should not be confused with the annual operating expenses that every shareholder pays.)

Advantage #15: Mutual funds provide a safe place for your investment money.

Mutual funds are required to hire an independent bank or trust company to hold and account for all the cash and securities in the pool. This custodian has a legally binding responsibility to protect the interests of every shareholder. No mutual fund shareholder has ever lost money due to a mutual fund bankruptcy.

Advantage #16: Mutual funds handle your paperwork for you.

Capital gains and losses from the sale of stocks, as well as dividend- and interest-income earnings, are summarized into a report for each shareholder at the end of the year for tax purposes. Funds also manage the day-to-day chores such as dealing with transfer agents, handling stock certificates, reviewing brokerage confirmations, and more.

Advantage #17: Mutual funds can be borrowed against in case of an emergency.

Although you hope it will never be necessary, you can use the value of your mutual fund holdings as collateral for a loan. If the need is short-term and you would rather not sell your funds because of tax or investment reasons, you can borrow against them rather than sell them.

Advantage #18: Mutual funds involve no personal liability beyond the investment risk in the portfolio.

Many investments, primarily partnerships and futures, require investors to sign papers wherein they agree to accept personal responsibility for certain liabilities generated by the undertaking. Thus, it is possible for investors to actually lose more money than they invest. This arrangement is generally indicative of speculative endeavors; I encourage you to avoid such arrangements. In contrast, mutual funds incur no personal risk.

Advantage #19: Mutual fund advisory services are available that can greatly ease the research burden.

Due to the tremendous growth in the popularity of mutual fund investing, there has been a big jump in the number of investment newsletters that specialize in researching and writing about mutual funds. My *Sound Mind Investing* newsletter, for example, offers model portfolios geared to your risk tolerance and stage of life. We provide specific buy/sell recommendations that are updated each month. (To learn more, go to www.SoundMindInvesting.com.)

Advantage #20: Mutual funds are heavily regulated by the federal government.

The fund industry is regulated by the Securities and Exchange Commission and is subject to the provisions of the Investment Company Act of 1940. The act requires that all mutual funds register with the SEC and that investors be given a prospectus, which must contain full information concerning the fund’s history, operating policies, cost structure, and so on. Additionally, all funds use a bank that serves as the custodian of all the pool assets. This safeguard means the securities in the fund are protected from theft, fraud, and even the bankruptcy of the fund management organization itself. Of course, money can still be lost if poor investment decisions cause the value of the pool's investments to fall in value.

Think of mutual funds as offering the convenience of something you're familiar with: eating out!

Someone else has done all the work of developing the recipes, shopping for quality at the best prices, and cooking and assembling the dinners so that foods that go well together are served in the right proportions. For mutual funds, that's the job of the professional portfolio manager — he or she develops his strategy, shops for the right securities at the best prices, and then assembles the portfolio with an appropriate amount of diversification. And the analogy doesn't stop there. Just as there are many different dinner entrees to choose from at most nice restaurants, there are also many kinds of mutual funds to choose from at most fund organizations. Each kind has its own "flavor."

There are three primary ways to profit from investing in mutual funds.

The price you pay for your shares is based on the worth of the securities in the pool on the day you buy in. Typically, the closing price is used for establishing their market value. For this reason, mutual funds are usually bought or sold only at the day's closing prices. This means that it doesn't matter what time of day the fund receives your order — early or late — you'll still get that day's closing price. (This is not the case with "exchange-traded funds," or ETFs, however.)

You can profit from your shares in three primary ways. First, the dividends paid by the stocks in the portfolio will be paid out to you periodically, usually quarterly. Second, if the portfolio manager sells a stock for more than he paid for it originally, a "capital gain" results. These gains will also be paid out periodically, usually annually. And third, when you're ready to sell your shares in the pool, you might receive back more than you paid for them!

Learn more about Christian investing and finances at the Sound Mind Investing website.