

Mutual funds or individual stocks... what's best for me?

Mutual funds?

Mutual funds are pools of money run by professionals who select stocks and bonds and buy them for the fund. Mutual funds generally contain hundreds or thousands of individual stocks and/or bonds at any one time. This offers instant diversification, which helps protect against loss and increases your chances for making money.

Diversifying works because different types of investments tend to move in different cycles. Some may go up while others go down. Others may move in the same direction, but not at the same rate or speed.

To invest in a mutual fund, a person buys shares of the fund, which adds to the pool of money available for investment. People can think of mutual fund shares as representing a fraction of each stock or bond the fund holds. Many mutual funds offer minimum initial investments of less than \$1,000 and subsequent investments of \$100 or less.

One important feature mutual funds offer is professional management. By investing in a mutual fund, an investor hires the mutual fund company to pick stocks and to decide when to buy and sell them.

But choosing a mutual fund takes time because investors should consider many things before making their decisions. The SEC recommends that investors consider items such as:

- The type of stocks, bonds, or other securities that the fund buys.
- The risk of the fund.
- Who runs the fund.
- The fund's track record or performance over time.
- The types of services offered by the fund company.
- The time it takes to keep track of how the fund is doing after investing.

Securities and Exchange Commission

The Securities and Exchange Commission (SEC) is the federal agency responsible for protecting investors and making sure the securities markets are fair. The SEC has created an on-line calculator to help people sort through the various fees mutual funds charge, and decide which fee structure would be the best for them.

Visit: sec.gov/investor/tools/mfcc/get-started.htm

You can buy or sell shares in a mutual fund on any business day. This means they are very "liquid." You can purchase mutual funds by mail, telephone, or on the Internet. This is very convenient for investors to transfer funds based on changing needs.

The costs of investing in mutual funds are sometimes higher than the cost of investing in individual stocks through a brokerage account, especially if the firm is a discount broker who offers a flat fee for each purchase.

Over time fees can significantly reduce returns.

Even if costs such as fees seem small in any one year, they can really add up over time and significantly reduce long-term returns.

Why would someone invest through a mutual fund if it costs more? Mutual funds offer several features, such as professional management, that are very important to some investors. For those people, the fees mutual funds charge may be well worth it because the mutual fund company picks the stocks and decides when to buy and sell them.

Mutual fund fees

Mutual funds charge several fees. The total amount of these fees can vary from a fraction of a percent of the amount invested to several percent of the amount invested per year.

There are two general types of mutual fund fees: *loads* and *annual fees*.

Loads can be either on the front or back end.

- Front-end loads* are sales charges applied to an investment at the time of initial purchase.

- Back-end loads* (also known as deferred sales charges, exit fees, or redemption charges) are charges an investor pays when withdrawing money from an investment.

Annual fees are expressed as the *expense ratio*—a percentage of the person's total investment. Fees called *12b-1* fees (used to cover the fund's promotional and marketing expenses)

and management fees are in this category.

Individual stocks?

People invest in individual stocks through accounts with brokerage firms. An investor opens an account by filling out forms and depositing money into the account. Investors typically must be at least 18 years old to open an account while younger investors need to have a parent or guardian open an account for them.

There are different types of brokerage firms, generally known as either discount brokers or full-service brokers. Discount brokers generally charge lower fees, but offer investors fewer services.

After you open the account, you tell the broker at the firm what stocks you want to buy or sell, and the broker carries out the order. You make all the decisions and have direct control over your investments. When you own individual shares, you control the amount of diversification you want and what works best for your investing goals.

One potential disadvantage of investing on your own is becoming emotional about your investments. As humans, we tend to be irrational about our own money! We second-guess ourselves, we don't want to regret bad decisions, and we hate to lose, much more than we love to win. Mutual funds don't consider your emotions. Select a mutual fund and the investing--and worrying--is left to the experts.

Investing in individual stocks takes a lot of time. Investors have to learn *how* to research individual stocks then do the research. They also need to keep track of the stocks they buy to decide when to buy or sell. Investors who can't take this time are better off hiring a mutual fund company to do the work.

Fees for buying stocks

Brokerage firms charge annual account fees as well as commissions. A commission is a fee the investor pays a broker for executing a transaction—buying or selling stock. The commission may be a flat fee—say \$75 per trade. It may be set at a certain amount per share of stock involved in the transaction. Or, it may be based on the total value of the transaction. It's important to ask questions and shop around for a broker.

More information on the Web

Be aware that these sites may contain advertisement for services and you may be asked to register. Some sites may contain both free and fee-based services. Remember to check federal tax laws for any recent updates or changes.

Fool.com offers investment guidance.

Morningstar.com rates stocks, bonds and mutual funds.

Smartmoney.com provides articles and information.

Cnnmoney.com provides articles and information.

Sec.gov gives investment advice from the U.S. Securities and Exchange Commission.