Investor.gov

U.S. SECURITIES AND EXCHANGE COMMISSION

Mutual Funds

What are mutual funds?

A mutual fund is an SEC-registered open-end investment company that pools money from many investors. It invests the money in stocks, bonds, short-term money-market instruments, other securities or assets, or some combination of these investments. The combined holdings the mutual fund owns are known as its portfolio, which is managed by an SEC-registered investment adviser. Each mutual fund share represents an investor's part ownership of the mutual fund's portfolio and the gains and losses the portfolio generates. Investors in mutual funds buy their shares from, and sell/redeem their shares to, the mutual funds themselves or through investment professionals like brokers or investment advisers.

Why do people buy mutual funds?

Mutual funds are a popular choice among investors because they generally offer the following features:

- **Professional Management.** Mutual funds are managed by investment advisers who are registered with the SEC.
- **Diversification.** Mutual funds may invest in a range of companies and industries rather than investing in one specific stock or bond. This helps to lower your risk if one company fails.
- **Low Minimum Investment.** Many mutual funds set a relatively low dollar amount for initial investment and subsequent purchases.
- **Liquidity.** Mutual fund investors can readily sell their shares back to the fund at the next calculated net asset value (NAV) (/introduction-investing/investing-basics/glossary/net-asset-value) – on any business day – minus any redemption fees.

How do I earn money from mutual funds?

Investors can make money from their mutual fund investments in three ways:

- **Dividend Payments.** A fund may earn income from its portfolio – for example, dividends on stock or interest on bonds. The fund then pays the shareholders nearly all the income, less expenses, as a dividend payment.

- **Capital Gains Distributions.** The price of the securities a fund owns may increase. When a fund sells a security that has increased in price, the fund has a capital gain. At the end of the year, the fund distributes these capital gains, minus any capital losses, to investors.
- **Increased Net Asset Value (NAV).** If the market value of a fund's portfolio increases, after deducting expenses and liabilities, then the NAV of the fund and its shares increases. With respect to dividend payments and capital gains distributions, mutual funds usually will give investors a choice. The mutual fund can transfer the amount to the investor, or the investor can have the dividends or distributions reinvested in the mutual fund to buy more shares.

What are the risks of investing in mutual funds?

Mutual funds are not guaranteed or insured by the FDIC or any other government agency. They therefore all carry some level of risk. You may lose some or all of the money you invest because the investments held by a fund can go down in value.

Dividends or interest payments may also change as market conditions change.

A fund's past performance is not as important as you might think because past performance does not predict future returns. But past performance can tell you how volatile or stable a fund has been over a period of time. The more volatile the fund, the higher the investment risk.

Different funds have different risks and rewards depending on their investment objectives. Generally, the higher the potential return, the higher the risk of loss.

What do I pay for my mutual fund?

As with any business, running a mutual fund involves costs. Funds pass along these costs to investors by deducting fees and expenses from NAV. That means you pay the fees and expenses indirectly.

Fees vary from fund to fund. It is important to understand what fees a mutual fund charges and how those fees impact your investment. Even small differences in fees can mean large differences in returns over time. In addition, a fund with high costs must perform better than a low-cost fund to generate the same returns for you.

Read more at Mutual Fund and ETF Fees and Expenses - Investor Bulletin (/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins-20) to learn about some of the most common mutual fund fees and expenses. Also check out the Financial Industry Regulatory Authority (FINRA) Fund Analyzer (/financial-tools-calculators/financial-tools/mutual-fund-analyzer) to compute how the costs of different mutual funds add up over time and eat into your returns.

What are some common mutual fund investing strategies?

- **Index Funds.** Index funds follow a passive investment strategy that is designed to achieve approximately the same return as a particular index before fees. An index fund will attempt to achieve its investment objective primarily by investing in the securities of companies that are included in a selected index. Passive management usually translates into less trading of the fund's portfolio (fewer transaction costs), more favorable income tax consequences (lower realized capital gains), and lower fees than actively managed funds.

- **Actively Managed Funds.** Actively managed funds are not based on an index. Instead, they seek to achieve a stated investment objective by investing in a portfolio of stocks, bonds, and other assets. An adviser of an actively managed fund may actively buy or sell investments in the portfolio on a daily basis without regard to conformity with an index. But the trades must be consistent with the overall investment objective and strategies of the fund. An actively managed fund has the potential to outperform the market or its chosen benchmark, but its performance is heavily dependent on the skill of the manager.

What types of mutual funds are there?

Mutual funds fall into several main categories. Each type has different features, risks, and rewards.

- Stock funds (/introduction-investing/investing-basics/glossary/stock-fund) invest primarily in stocks or equities. A stock is an instrument that represents an ownership interest (called equity) in a company and a proportional share in the company's assets and profits. The types of stocks owned by a stock fund depend upon the fund's investment objectives, policies, and strategies. A stock fund's value can rise and fall quickly (and dramatically) over the short term. The fund's performance depends on whether the underlying companies do well or not.

- Bond funds (/introduction-investing/investing-basics/glossary/bond-funds-and-income-funds) or income funds invest primarily in bonds or other types of debt securities. Depending on its investment objectives and policies, a bond fund may concentrate its investments in a particular type of bond or debt security or a mixture of types. The securities that bond funds hold will vary in terms of risk, return, duration, volatility and other features.
- Target date funds (/news-alerts/investor-bulletins/target-date-retirement-funds) typically hold a mix of stock funds, bond funds and other funds, and are created for individuals with a particular date for retirement or other goal in mind. Target date funds are designed to make investing for retirement or other goals more convenient by changing their investment mix as the target date gets closer. However, be aware that if a target date fund invests in other funds, it may charge a double layer of fees.

- Money market funds (/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins/updated-12) invest in liquid, short-term debt securities, cash and cash equivalents. Many investors use money market funds to store cash or as an alternative to bank savings vehicles.

How do I buy and sell mutual funds?

Investors buy and sell mutual fund shares from/to the fund itself or through a broker or investment adviser, rather than from/to other investors on national securities markets. The purchase price is the next calculated NAV, plus any fees charged at the time of purchase. Mutual fund shares are redeemable. This means investors can sell the shares back to the fund at any time at the next calculated NAV, minus any fees charged at the time of redemption.

What should I consider before investing in mutual funds?

- Before investing in a mutual fund, you should carefully read the fund's available information (https://www.investor.gov/additional-resources/general-