

Making Everything Easier!™

6th Edition

Mutual Funds

FOR DUMMIES®

Learn to:

- Plan and implement a successful investment strategy that includes mutual funds

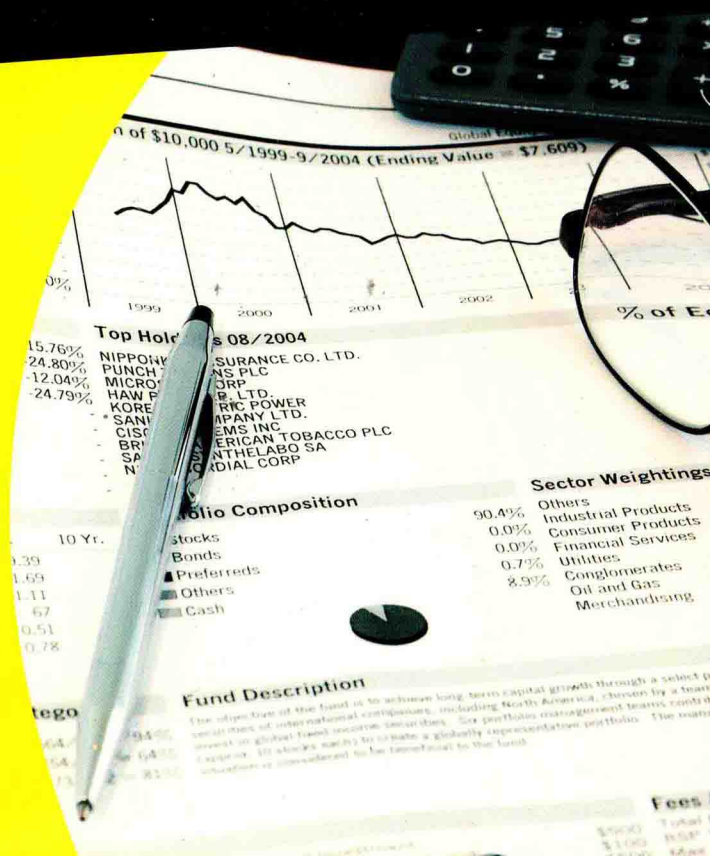
Find the best-managed funds that match your financial goals

Avoid fund-investing pitfalls

Select among mutual funds, exchange-traded funds (ETFs), and other investing options

Eric Tyson

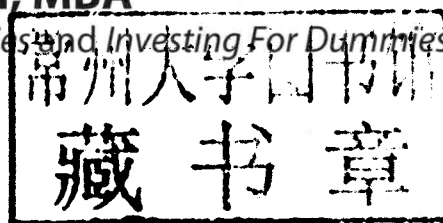
Bestselling author, Investing For Dummies



Mutual Funds FOR **DUMMIES®** 6TH EDITION

by Eric Tyson, MBA

Author of *Personal Finance For Dummies* and *Investing For Dummies*



WILEY

Wiley Publishing, Inc.

Mutual Funds For Dummies®, 6th Edition

Published by
Wiley Publishing, Inc.
111 River St.
Hoboken, NJ 07030-5774
www.wiley.com

Copyright © 2010 by Eric Tyson

Published by Wiley Publishing, Inc., Indianapolis, Indiana

Published simultaneously in Canada

No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning or otherwise, except as permitted under Sections 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, 222 Rosewood Drive, Danvers, MA 01923, (978) 750-8400, fax (978) 646-8600. Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, (201) 748-6011, fax (201) 748-6008, or online at <http://www.wiley.com/go/permissions>.

Trademarks: Wiley, the Wiley Publishing logo, For Dummies, the Dummies Man logo, A Reference for the Rest of Us!, The Dummies Way, Dummies Daily, The Fun and Easy Way, Dummies.com, Making Everything Easier, and related trade dress are trademarks or registered trademarks of John Wiley & Sons, Inc. and/or its affiliates in the United States and other countries, and may not be used without written permission. All other trademarks are the property of their respective owners. Wiley Publishing, Inc., is not associated with any product or vendor mentioned in this book.

LIMIT OF LIABILITY/DISCLAIMER OF WARRANTY: THE PUBLISHER AND THE AUTHOR MAKE NO REPRESENTATIONS OR WARRANTIES WITH RESPECT TO THE ACCURACY OR COMPLETENESS OF THE CONTENTS OF THIS WORK AND SPECIFICALLY DISCLAIM ALL WARRANTIES, INCLUDING WITHOUT LIMITATION WARRANTIES OF FITNESS FOR A PARTICULAR PURPOSE. NO WARRANTY MAY BE CREATED OR EXTENDED BY SALES OR PROMOTIONAL MATERIALS. THE ADVICE AND STRATEGIES CONTAINED HEREIN MAY NOT BE SUITABLE FOR EVERY SITUATION. THIS WORK IS SOLD WITH THE UNDERSTANDING THAT THE PUBLISHER IS NOT ENGAGED IN RENDERING LEGAL, ACCOUNTING, OR OTHER PROFESSIONAL SERVICES. IF PROFESSIONAL ASSISTANCE IS REQUIRED, THE SERVICES OF A COMPETENT PROFESSIONAL PERSON SHOULD BE SOUGHT. NEITHER THE PUBLISHER NOR THE AUTHOR SHALL BE LIABLE FOR DAMAGES ARISING HEREFROM. THE FACT THAT AN ORGANIZATION OR WEBSITE IS REFERRED TO IN THIS WORK AS A CITATION AND/OR A POTENTIAL SOURCE OF FURTHER INFORMATION DOES NOT MEAN THAT THE AUTHOR OR THE PUBLISHER ENDORSES THE INFORMATION THE ORGANIZATION OR WEBSITE MAY PROVIDE OR RECOMMENDATIONS IT MAY MAKE. FURTHER, READERS SHOULD BE AWARE THAT INTERNET WEBSITES LISTED IN THIS WORK MAY HAVE CHANGED OR DISAPPEARED BETWEEN WHEN THIS WORK WAS WRITTEN AND WHEN IT IS READ.

For general information on our other products and services, please contact our Customer Care Department within the U.S. at 877-762-2974, outside the U.S. at 317-572-3993, or fax 317-572-4002.

For technical support, please visit www.wiley.com/techsupport.

Wiley also publishes its books in a variety of electronic formats. Some content that appears in print may not be available in electronic books.

Library of Congress Control Number: 2010929313

ISBN: 978-0-470-62321-3

Manufactured in the United States of America

10 9 8 7 6 5 4 3 2 1



Praise for Eric Tyson's Mutual Funds For Dummies®

"Eric Tyson gets it. *Mutual Funds For Dummies* cuts through the clutter that clouds personal finance for millions of Americans. This is a must-read for the savvy investor and novice alike."

— **Gerry Dick, Indianapolis Economic Development Corp., and Host, *Indiana Business This Week*, WRTV/WFYI-TV, Indianapolis**

"I was clueless and intimidated by the terminology and information that I need to know about investing into mutual funds. This book has given me confidence as well as a sturdy foundation to begin investing."

— **Clifford Record, Colt's Neck, New Jersey**

"You don't have to be a novice to like *Mutual Funds For Dummies*. . . . Author Eric Tyson clearly has a mastery of his subject. He knows mutual funds and he knows how to explain them in simple English. . . . It's hard to imagine a more accessible sourcebook."

— **Kiplinger's Personal Finance Magazine**

"*Mutual Funds For Dummies* . . . is an excellent source for not only the novice investor but also for someone looking to enhance their understanding of one of the fastest growing investment tools."

— **Northwest Arkansas Times**

"I handle my mother's money and my own family's, so it is very important that I make all the right moves and decisions. I didn't have any confidence until I studied Eric Tyson's books."

— **Lisa Patten, Lake Junaluska, NC**

". . . Injects common sense into the dizzying world of mutual funds."

— **Oakland Tribune, CA**

"I liked how easy the book is to read. I understand more now about mutual funds than I did before I read the book — it's excellent."

— **Dennis Pippet, Lansing, MI**

"A book that should help investors be smarter . . . readable, comprehensive. . . . Tyson's encyclopedic book is chockful of useful examples and advice for both new and experienced investors. . . ."

— **Christian Science Monitor**

"*Mutual Funds For Dummies* . . . brought me up to speed financially."

— **Riccardo Heald, New York, NY**

"Comprehensive, well-organized information in an easy-to-read format."

— **Dianne L. Zimmerman, Rockville, MD**

"*Mutual Funds For Dummies* gives good common sense advice about putting your financial house in order."

— **John B. Fout, MBA**

"I wish my finance teachers in college had been this interesting and informative."

— **Lori Buono, reader**

"Eric Tyson is far and away the best writer, most readable author, and most honest and intelligent voice in America today in the areas of personal finance and mutual fund investing."

— **David Diaman, Enrolled Agent**

"Never have I been as impressed with the advice and insight offered by a columnist, as I have been by Eric Tyson! Finally, there is someone in print cogently and lucidly speaking financial truth and common sense."

— **Kenneth S. Imbriale, Staten Island, NY**

"Accurate, easy-to-read, and humorous; 'teaches' the reader rather than preaching at the reader!"

— **Victoria L. Simmons, High Point, NC**

Mutual Funds

FOR

DUMMIES®

6TH EDITION

Pick up the latest edition of these other bestsellers, also by Eric Tyson, published by Wiley Publishing, Inc.

Investing For Dummies®

Personal Finance For Dummies®

Home Buying For Dummies®, with Ray Brown

House Selling For Dummies®, with Ray Brown

Mortgages For Dummies®, with Ray Brown

Taxes For Dummies®, with David J. Silverman and Margaret Atkins Munro

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.

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.

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

Many people contribute to the birth of a book, and this book is no exception. First, I owe a deep debt of gratitude to James Collins, who inspired me when I was a young and impressionable business school student. Jim encouraged me to try to improve some small part of the business world by being an entrepreneur and focusing solely on what customers needed rather than on what made the quickest buck.

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

We're proud of this book; please send us your comments at <http://dummies.custhelp.com>. For other comments, please contact our Customer Care Department within the U.S. at 877-762-2974, outside the U.S. at 317-572-3993, or fax 317-572-4002.

Some of the people who helped bring this book to market include the following:

Acquisitions, Editorial, and Media Development

Project Editor: Kelly Ewing (*Previous Edition:*
Chad R. Sievers, Mike Baker)

Senior Acquisitions Editor: Mike Baker

Assistant Editor: Erin Calligan Mooney

Senior Editorial Assistant: David Lutton

General Reviewer: Mercer Bullard

Senior Editorial Manager: Jennifer Ehrlich

Editorial Supervisor and Reprint Editor:
Carmen Krikorian

Editorial Assistant: Jennette ElNaggar

Cover Photo: © Gaertner/Alamy

Cartoons: Rich Tennant
(www.the5thwave.com)

Composition Services

Project Coordinator: Katherine Crocker

Layout and Graphics: Carl Byers

Proofreaders: John Greenough, Toni Settle

Indexer: Sharon Shock

Publishing and Editorial for Consumer Dummies

Diane Graves Steele, Vice President and Publisher, Consumer Dummies

Kristin Ferguson-Wagstaffe, Product Development Director, Consumer Dummies

Ensley Eikenburg, Associate Publisher, Travel

Kelly Regan, Editorial Director, Travel

Publishing for Technology Dummies

Andy Cummings, Vice President and Publisher, Dummies Technology/General User

Composition Services

Debbie Stailey, Director of Composition Services

Contents at a Glance

Introduction	1
Part I: Mutual Funds: Sharing Risks and Rewards.....	7
Chapter 1: Making More Money, Taking Less Risk.....	9
Chapter 2: Mutual Funds: Pros and Cons	23
Chapter 3: Funding Your Financial Plans.....	39
Part II: Evaluating Alternatives to Funds.....	55
Chapter 4: Selecting Your Own Stocks and Bonds	57
Chapter 5: Exchange-Traded Funds and Other Fund Lookalikes	65
Chapter 6: Hedge Funds and Other Managed Alternatives	75
Part III: Separating the Best from the Rest.....	83
Chapter 7: Finding the Best Funds.....	85
Chapter 8: Using Fund Publications	101
Chapter 9: Buying Funds from the Best Firms	119
Part IV: Crafting Your Fund Portfolio.....	137
Chapter 10: Perfecting a Fund Portfolio	139
Chapter 11: Money Market Funds: Beating the Bank	159
Chapter 12: Bond Funds: When Boring Is Best	177
Chapter 13: Stock Funds: Meeting Your Longer Term Needs	207
Chapter 14: Specialty Funds: One of a Kind	229
Chapter 15: Working It Out: Sample Portfolios.....	237
Chapter 16: Applications, Transfers, and Other Useful Forms	261
Part V: Keeping Current and Informed.....	279
Chapter 17: Evaluating Your Funds and Adjusting Your Portfolio.....	281
Chapter 18: The Taxing Side of Mutual Funds	299
Chapter 19: Common Fund Problems and How to Fix Them	315
Chapter 20: Fund Ratings and Forecasters.....	325
Chapter 21: Harnessing Your Computer's Power	337

<i>Part VI: The Part of Tens</i>	345
Chapter 22: Ten Common Fund-Investing Mistakes and How to Avoid Them.....	347
Chapter 23: Ten Fund-Investing Fears to Conquer	351
Chapter 24: Ten Tips for Hiring a Financial Adviser	357
<i>Appendix: Recommended Fund Companies and Discount Brokers</i>	367
<i>Index</i>	369

Table of Contents

Introduction 1

What's New in This Edition	1
How This Book Is Different.....	2
Foolish Assumptions.....	3
How This Book Is Organized	4
Part I: Mutual Funds: Sharing Risks and Rewards	4
Part II: Evaluating Alternatives to Funds	4
Part III: Separating the Best from the Rest	4
Part IV: Crafting Your Fund Portfolio	5
Part V: Keeping Current and Informed.....	5
Part VI: The Part of Tens.....	5
Icons Used in This Book	6
Where to Go from Here.....	6

Part I: Mutual Funds: Sharing Risks and Rewards 7

Chapter 1: Making More Money, Taking Less Risk 9

Introducing Mutual Funds	9
Making Sense of Investments.....	10
Lending investments: Interest on your money	10
Ownership investments: More potential profit (and risk)	11
Surveying the Major Investment Options.....	12
Savings and money market accounts.....	13
Bonds.....	13
Stocks	14
Overseas investments	15
Real estate.....	16
Gold, silver, and the like	16
Annuities	16
Life insurance	17
Limited partnerships.....	18
Reviewing Important Investing Concepts.....	19
Getting a return: Why you invest.....	19
Measuring risks: Investment volatility	19
Diversifying: A smart way to reduce risk.....	21

Chapter 2: Mutual Funds: Pros and Cons 23

Getting a Grip on Mutual Funds.....	23
Financial intermediaries	24
Open-end versus closed-end funds	25

Opting for Mutual Funds	27
Fund managers' expertise	27
Funds save you money and time	28
Fund diversification minimizes your risk	30
Funds undergo regulatory scrutiny	31
You choose your risk level	31
Fund risk of bankruptcy is nil	32
Funds save you from sales sharks	33
You have convenient access to your money	33
Addressing the Drawbacks	34
Don't worry about these	35
Worry about these (but not too much)	35

Chapter 3: Funding Your Financial Plans 39

The Story of Justine and Max	39
Lining Up Your Ducks Before You Invest	41
Pay off your consumer debts	41
Review your insurance coverage	42
Figure out your financial goals	42
Determine how much you're saving	43
Examine your spending and income	43
Maximize tax-deferred retirement account savings	44
Determine your tax bracket	45
Assess the risk you're comfortable with	45
Review current investment holdings	46
Consider other "investment" possibilities	46
Reaching Your Goals with Funds	46
The financial pillow — an emergency reserve	47
The golden egg — investing for retirement	48
The white picket fence — saving for a home	52
The ivory tower — saving for college	52

Part 11: Evaluating Alternatives to Funds 55

Chapter 4: Selecting Your Own Stocks and Bonds 57

Choosing Your Own Stocks and Bonds	57
Beware the claims of stock-picking gurus	58
Know the drawbacks of investing in individual securities	60
Understand the psychology of selecting stocks	62
How to Pick Your Own Stocks and Bonds	63

Chapter 5: Exchange-Traded Funds and Other Fund Lookalikes. . . . 65

Understanding Exchange-Traded Funds	65
Understanding ETF advantages	66
Eyeing ETF drawbacks	67
Seeing the pros and cons of trading ETFs	69
Identifying the best ETFs	69

Mimicking Closed-End Funds: Unit Investment Trusts	71
Customizing Your Own Funds Online	72
Chapter 6: Hedge Funds and Other Managed Alternatives	75
Hedge Funds: Extremes of Costs and Risks	76
Getting the truth about hedge funds	76
Investigating hedge funds	78
Wrap (Or Managed) Accounts: Hefty Fees	80
Private Money Managers: One-on-One	82
 <i>Part III: Separating the Best from the Rest</i>	 83
Chapter 7: Finding the Best Funds	85
Evaluating Gain-Eating Costs	85
Losing the load: Say no to commissions	86
Considering a fund's operating expenses	92
Weighing Performance and Risk	93
Star today, also-ran tomorrow	94
Apples to apples: Comparing performance numbers	97
Recognizing Manager Expertise	99
Chapter 8: Using Fund Publications	101
Reading Prospectuses — the Important Stuff, Anyway	101
Cover page	102
Fund profile	103
Other fund information	105
Investment objectives and risks	105
Investment adviser	108
Financial highlights	108
Reviewing Annual Reports	111
Chairman's letter and performance discussion	111
Investment adviser's thoughts	114
Performance and its components	114
Investment holdings	115
Investigating the Statement of Additional Information (SAI)	117
Chapter 9: Buying Funds from the Best Firms	119
Finding the Best Buys	119
The Vanguard Group	120
Fidelity Investments	121
Dodge & Cox	122
Oakmark	123
T. Rowe Price	123
TIAA-CREF	123
Other fund companies	124

Discount Brokers: Mutual Fund Supermarkets.....	125
Buying direct versus discount brokers.....	126
Debunking “No Transaction Fee” funds.....	128
Using the best discount brokers.....	129
Places to Pass By.....	130
Hiring an Adviser: The Good, Bad, and Ugly.....	131
The wrong reason to hire an adviser.....	131
The right reasons to hire an adviser.....	132
Beware of conflicts of interest.....	132
Your best options for help.....	133
If you seek a salesperson.....	135

Part IV: Crafting Your Fund Portfolio..... 137

Chapter 10: Perfecting a Fund Portfolio.....139

Asset Allocation: An Investment Recipe.....	139
Allocating to reduce your risks.....	140
Looking toward your time horizon.....	140
Taxes: It’s What You Keep That Matters.....	144
Fitting funds to your tax bracket.....	145
Minimizing your taxes on funds.....	147
Fund Investing Strategies.....	149
Timing versus buy-and-hold investing.....	149
Active versus index fund managers.....	150
Putting Your Plans into Action.....	152
Determining how many funds and families to use.....	153
Matching fund allocation to your asset allocation.....	154
Allocating when you don’t have much to allocate.....	156
Investing large amounts: To lump or to average?.....	156
Sorting through your existing investments.....	158

Chapter 11: Money Market Funds: Beating the Bank159

Money Market Funds 101.....	160
Comparing money funds with bank accounts.....	160
Finding uses for money funds.....	161
Refuting common concerns.....	163
Grasping what money funds invest in.....	167
Choosing a Great Money Market Fund.....	169
Why yield and expenses go hand in hand.....	169
Looking at your tax situation.....	170
Deciding where you want your home base.....	171
Keeping your investments close to home.....	172
Considering other issues.....	172
Finding the Recommended Funds.....	173
Taxable money market funds.....	173
U.S. Treasury money market funds.....	173
Municipal tax-free money market funds.....	174

Chapter 12: Bond Funds: When Boring Is Best177

Understanding Bonds	177
Sizing Up a Bond Fund's Personality.....	178
Maturity: Counting the years until you get your principal back	179
Duration: Measuring interest rate risk.....	180
Credit quality: Determining whether bonds will pay you back ...	182
Issuer: Knowing who you're lending to.....	182
Management: Considering the passive or active type	183
Inflation-indexed Treasury bonds.....	184
Investing in Bond Funds	186
Why you might (and might not) want to invest in bond funds....	186
How to pick a bond fund with an outcome you can enjoy	188
How to obtain tax-free income	191
Eyeing Recommended Bond Funds.....	192
Short-term bond funds	192
Intermediate-term bond funds	195
Long-term bond funds.....	198
Exploring Alternatives to Bond Funds	200
Certificates of deposit	201
Individual bonds	202
Guaranteed-investment contracts	204
Mortgages	205
Exchange-traded bond funds	206

Chapter 13: Stock Funds: Meeting Your Longer Term Needs.207

The Stock Market Grows Your Money	208
Be patient.....	209
Add regularly to your stock investments	210
Using Mutual Funds to Invest in Stocks.....	211
Reducing risk and increasing returns	211
Making money: How funds do it.....	212
Seeing your stock fund choices	213
The Best Stock Funds.....	215
Mixing it up: Recommended hybrid funds	216
Letting computers do the heavy lifting: Recommended index funds.....	220
Keeping it local: Recommended U.S.-focused stock funds	222
Being worldly: Recommended international funds	225
Expanding your horizon: Recommended global stock funds.....	226

Chapter 14: Specialty Funds: One of a Kind.229

Sector Funds: Should You or Shouldn't You Invest in Them?	229
Landlording Made Easy: Real Estate Investment Trust (REIT) Funds.....	230
Profiting from What Everyone Needs: Utility Funds	231
Arming for Armageddon: Precious Metals Funds.....	231
Commodity Funds	233
Hedging: Market Neutral (Long-Short) Funds.....	234