INTRODUCTION TO:
Investment Companies (Mutual Funds)
Investment COMPANIES

**Definition:**
An investment company owns a portfolio of securities and other assets and allows people to invest in their portfolio. The investment company invests the money it receives from investors on a collective basis, and each investor shares in the profits and losses in proportion to the investor’s interest in the investment company. Types of investment companies include:

- **Open-End:** Open-End companies are “redeemable,” meaning that when investors want to sell their shares, they can sell them back to the company at their current Net Asset Value (NAV) per share.
- **Closed-End:** Closed-end companies trade like stocks in that investors are issued a number of fixed shares at inception and the company is not required to buy its shares back from investors upon request.
- **Diversified:** In order to qualify as a diversified investment company, 75% of the portfolio must be held in cash, government securities, or other securities and no more than 5% of the company’s total assets can be invested in one company. They also cannot hold more than 10% of outstanding shares of any one company.
- **Non-Diversified:** Portfolios that do not meet the qualifications listed above cannot state to the public that it is diversified.

**CLOSED-END CHARACTERISTICS**

- **Trading:** Closed-End companies trade similar to common stocks.
- **Risk:** They can trade higher or lower than NAV due to supply/demand conditions.
- **Margin:** The securities within the portfolio are marginable, meaning they can be used as collateral in a margin account, if they are listed on an exchange.
- **Costs:** Shares are purchased or sold at the bid or ask price plus a commission.

**OPEN-END CHARACTERISTICS**

- **Trading:** Mutual Funds trade differently than common stock. A holder can receive his or her proportionate share to the NAV by selling the security back to the issuer.
- **Continuous Issue:** When a new purchaser wants shares, more shares can be issued. Sold shares are retired by the fund.
- **Margin:** Shares can generally not be purchased on margin; however, after 30 days they may be used as collateral to meet margin calls.
DEFINITION

Mutual funds are a type of an open-end investment company, meaning they are redeemable for the NAV. A mutual fund’s portfolio is structured and maintained to match the investment objectives stated in its prospectus.

DIVERSIFICATION

Mutual Funds allow investors to purchase a proportional interest of a fund of securities. The transaction costs associated with purchasing mutual fund shares are generally less than the costs associated with purchasing the individual securities in the fund. Investors can diversify without having to actively manage the individual securities in their portfolios.

MUNICIPAL BOND FUNDS:
Municipal Bond Funds invest in municipal bonds. These funds often invest in Municipal Bonds of a particular state (i.e. a CA Municipal Bond Fund). Gains from these funds often have similar tax advantages as investing in Municipal Bonds.

INDEX FUNDS:
Index Funds invest in securities to match a particular index (i.e. Dow Jones Industrials). They are usually passively managed with lower management fees.

SECTOR FUNDS:
Sector Funds invest in securities in a particular sector (i.e. technology stocks).

INTERNATIONAL FUNDS:
International Funds invest in securities based on geography (i.e. Emerging Growth Funds, European Funds).

GROWTH FUNDS:
Growth Funds invest in securities in growth oriented stocks.

INCOME FUNDS:
Income Funds invest in income-producing securities.

MONEY MARKET FUNDS:
Money Market Funds invest in liquid assets and aim to keep their NAV at $1 per share.
**Reasons to Invest in MUTUAL FUNDS**

**Reasons to Invest**

- **Active Management**
  Funds regularly align their investments to meet the stated objectives without the investor having to place orders to do so.

- **Reduced Sales Charges**
  Many funds have a reduced sales charge with a minimum level of investment (a breakpoint).

- **Consistent Diversification**
  Even if a portion of a mutual fund holding is liquidated, the remaining shares remain as diversified as the fund itself.

- **Transaction Costs**
  Costs associated with Mutual Fund investing are often significantly lower than transaction costs of purchasing individual securities. Instead of paying a transaction cost on a per trade basis, the investor typically pay a fixed percentage on the entire mutual fund as a whole. Thus, in most cases the investor pays a significantly lower transaction fee on a larger and more diversified portfolio that is professionally managed.

- **Fund Families**
  Many funds offer free or minimal transaction fees for switching funds within their family (i.e. Switching from an ABC Co. Emerging Growth Fund to an ABC Co. Bond Fund).

**Risks & Investment CHOICES**

**RISKS**

- Capital Loss: As with all securities investments, loss can occur if the underlying securities fall in value, involving loss of your initial investment.
- Fees: Some funds charge higher fees than others for fund management.
- Control: Unlike individual stocks, an investor in a mutual fund cannot control when or how much of the underlying securities are bought or sold.

**INVESTMENT CHOICES**

- Fund Families often offer breakpoints for purchases of different funds within a fund family.
- Many funds offer shareholders the ability to automatically reinvest all or part of a capital gains distribution (payouts from appreciation in the fund).
- Each fund is required to provide a prospectus and semi-annual update to investors

**Fun Facts**

- Mutual funds have been actively traded in the United States since the 1920s.
- Thousands of Mutual Funds are available for purchase with objectives to meet the individual needs of almost any investor.
- Mutual funds range from very low risk (money market funds) to very high risk (speculative funds) investments.
Disclaimer

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