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WISERWoman

A QUARTERLY NEWSLETTER FROM THE WOMEN'S INSTITUTE FOR A SECURE RETIREMENT

WISER Special Report

Mutual Fund Investing: What You Need to Consider When Choosing Your Mutual Funds

Today, even Wall Street's money managers are concerned about *risk*: the threats of terrorism, war and a troubled economy that are crippling the stock market for the third year in a row. According to a recent monthly survey by a large financial company, money managers are as frozen as the average investor and afraid of making mistakes. If the managers of the mutual funds are frozen then what's the average investor to do? This report discusses some of the investment concepts and goals that you should consider when you invest in mutual funds.

Investment Basics

Knowing key terms and concepts is important. There are two general concepts to consider when choosing mutual funds: total rate of return and risk.

Rate of Return

The total **rate of return** indicates how much a fund has increased in value over time. The rate is figured on the change in value of the underlying stocks or bonds in a fund, plus the income generated from those stocks or bonds.

It is usually expressed as an average annualized percentage figure — that is, the percent of increase in value for a year, averaged for several years.

Mutual Fund Terms

Rate of return — The amount that a mutual fund has increased (or decreased) in value, often calculated for one year or several years.

Risk or Volatility — The degree of uncertainty about whether you will make or lose money, and how much, on a stock or mutual fund. With a more volatile stock, you have a greater chance for greater gains, but also for greater losses.

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Inside

From WISER's Executive Director

Most financial experts agree that investors need more financial education. In each issue we try to take on a subject that is difficult and not ordinarily written about in the popular press. Issues that need to be understood even by beginning investors. This Winter issue is focused on the risk of mutual funds and why diversification is important. Many of us have put money into mutual funds with no idea why we are in *this* particular fund versus that fund. Often choices are made upon the recommendation of a friend or family member. That's because study after study shows that most people do not have the time, interest about finances or the expertise to make wise choices. But we are not alone, despite hundreds of books on financial education there is only a small segment of people who understand the complicated world of investing.

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For example, if a fund has an average five-year total rate of return of 10%, this means that for the last five years — if averaged out — it increased in value 10% per year. If $10,000 had been invested five years ago, it would now be worth $16,105. The value of the fund increased $6,105: $5,000 is the result of the straight 10% return, and the additional $1,106 is the result of compounding — it earned a return on previous earnings.

Risk or Volatility

Selecting different funds with different rates of risk is an advised strategy. Usually, the more return a fund provides, the more risky (or volatile) it will be. Usually experts analyze and try to manage *risk* so they can balance their investments — for instance, some companies will do well no matter what is happening in the global world: such as companies who sell drugs, food and household products.

The investment community usually defines **risk** in a very mathematically technical way, known as standard deviation. Think of this type of risk as volatility per year. Say you were choosing between several mutual funds, each of which had an average rate of return of 10%, but which had a range of standard deviations between, e.g., 8% and 20%, you would probably choose the fund with lower volatility.

Now, what might lead you to pick a mutual fund that had a certain rate of return and risk pattern?

Three Basic Factors:

- **how many years to retirement**
- **your attitude about risking your money**
- **your overall financial position**

How many years will it be until you retire?

In general, if you have more years until you are planning to retire you may choose a fund with higher return and higher risk. If you are going to retire in twenty years, there will be many ups and downs in the stock market (and your mutual fund), therefore, you can accept more risk in order to get more return.

On the other hand, if you are going to retire in three years, you may begin to move money away from higher return/higher risk funds into lower

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Mutual Fund Terms

Equity – Investments in the stock market.

Growth funds – Mutual funds that invest primarily in stocks that are focused on increasing the value or price of the stock as the primary goal.

Income funds – Mutual funds that have the goal of providing stable income by investing in stocks and bonds that pay dividends and interest.

Value funds—Mutual funds that usually pay a portion of their earnings in a dividend. Over the long term, value investing has outperformed growth funds in which companies reinvest profits in their businesses to allow them to grow.

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return/lower risk funds, such as a mixed equity/bond fund or an all bond fund. Since you will need the money sooner rather than later, you cannot risk the potential loss that might occur if the stock market drops. Specifically, if the market were to go into a down cycle when you needed to sell your mutual funds, you would have to sell at a lower rate than would be the case if you could wait a few years for the stock market to come back up. For this reason, the sooner you need access to the money you have invested, the more stable the investment funds should be.

Your attitude about risking your money

A second factor in choosing a risk/rate of return pattern might be **your own attitude toward risk.** Some people are very averse to risk and would rather accept lower return and sleep easier at night than to ride on the stock market's recent roller coaster trip. Some people are very accepting of risk. So take on only as much as you can handle.

Index Funds

Noted financial journalist Beth Kobliner, has written for *WISER-Woman* about one type of mutual fund — the S&P 500 Index fund, which tracks changes in the stock prices of 500 large companies. The S&P 500 has no fund manager and low fees. While these days it's difficult to know where to start, we still believe that index funds are an excellent place. But, a well-informed (& Wiser) investor should also understand the broader range of mutual funds.

A third factor is your **overall financial position**. Obviously the greater your assets, or stream of future income, the more risk might be acceptable to you.

Investment Objectives and Styles of Mutual Funds

Armed with this understanding of return versus risk, let's examine the different investment objectives and styles that mutual funds offer.

Stocks vs. Bond Mutual Funds

Most people probably think of stocks (equity) when they think of mutual funds. However, there are also bond mutual funds and balanced funds, i.e. mixtures of stocks and bonds. The same thoughts that apply to return and risk also apply to bonds versus stocks. The further away you are from retirement, the more equity you

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Finding a Financial Advisor Who Works for You

One of the most important aspects of financial planning is selecting your financial advisor. You need to find someone who's qualified, who understands your unique needs and someone you can trust — quite a challenge.

Part of the difficulty in selecting a financial planner comes from the different ways in which these advisors are paid. Traditionally, most financial professionals have been paid by commission. That is, they receive a percentage of the payment that their clients make for financial products, whether those products are stocks or mutual funds, bonds or bond funds, insurance, or other products. These advisors have incentives to suggest specific investments that are either promoted by their firms or pay larger commissions than others. Now, these investments *might* be in your best interest, but they might not. But it's clear that the advisor has a compelling interest to favor one mutual fund over another, or one type of investment over another.

How can you avoid this inherent conflict of interest? Many people have discovered that the best thing to do is to find financial advisors who are not basing their advice on their commissions. Advisors who are called "Fee-Only" advisors.

NAPFA, the National Association of Personal Financial Advisors, is the leading organization of Fee-Only financial advisors and has more than 750 members — many NAPFA members have developed practices designed for individuals and families who need high-quality financial advice but do not have million-dollar portfolios.

Among its many activities, NAPFA acts as a clearinghouse that puts individuals and families in contact with Fee-Only advisors — more than 30,000 people each year request referrals. For more information call 800-366-2732 or go to www.napfa.org.

(Kevin Adler, publications editor for National Association of Financial Planners (NAPFA)contributed to this article).

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might want to have. For example, if you have twenty years until retirement, you might want to be invested 80% in stocks. On the other hand, if you are going to retire in two or three years, you may want to be 80% in bonds.

Bond Mutual Funds

Bond mutual funds invest in bonds that mature at different times – they range from short-term to intermediate-term to long-term. Bond funds invest in bonds that are either corporate or government. Finally, bond funds vary in terms of the quality of the underlying bonds – at one end of the scale are bonds that are very safe with relatively low interest, and at the other end are "junk bonds" that pay high interest.

You should also note that bond funds can be either taxable or non-taxable (municipal). Most of us invest through a 401(k)-type retirement account or an individual retirement account (IRA), which are already tax-deferred.

Life Cycle Funds

An easy way to diversify is choosing one of the life-cycle mutual funds labeled by date. For instance, if you want to retire in 2020, you buy into a 2020 fund.

Life-stage funds are similar but its up to the investors to shift their money as they age.

Balanced funds also offer a mix of stocks and bonds. Many of the big families of funds such as Vanguard and T. Rowe Price offer these types of funds.

Once again, your rate of return/risk profile will determine what bond funds you may want. Short-term government or corporate bond funds will be the safest and return the least. Long-term corporate or government funds will be riskier and have a higher rate of return.

Stock Fund Investment Objectives

Stock mutual funds (also called equity funds) are often divided into three different types of fund objectives: growth, income, or a mixture of growth and income. Those with a **growth objective** seek capital appreciation — growth in the value of the fund — and tend to have higher returns and risk. **Income-oriented** funds emphasize dividends — periodic payments to the stock or fund holders — over capital appreciation. These tend to have lower returns and risk. Many funds seek both growth and income, and have a corresponding array of return/risk profiles.

Stock Fund Investment Styles

The term "growth" also applies to the final way in which mutual funds differ, i.e. **investment style. Growth funds** invest primarily in growth stocks. These are the stocks of companies which have higher rates of earnings growth than average. Examples of such stocks would be technology or drug stocks. On the other hand, **value funds** invest in stocks that have slower, but generally more predictable, growth rates. Examples might be financial or utility companies. In general, growth funds tend to be riskier and have higher returns and value funds tend to be less risky with lower returns.

Diversification

Perhaps the most important concept to understand and abide by in investing is **diversification**. Over any longer period of time, markets will not only increase and decrease in value but will change with regard to what style is "hot". So, the most sensible approach to investing over time is to diversify, that is, to have a mixture of **growth** funds, **value** funds and **bond** funds. Or if you prefer, and your resources are small, invest in a fund or two that diversifies across style.

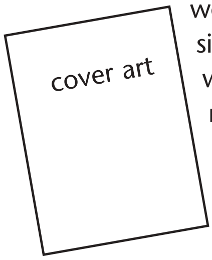
Many investors are angry about their poor investment results over the past three years. But some investors who have learned the basics and kept their money **diversified** are holding their own. Mutual fund investors who are concerned about risk need to take charge and monitor their funds closely. A new free service that allows you to monitor a fund's risk can be found at www. Riskgrades.com.

A final word of caution

Having several mutual funds does not guarantee diversification. The more funds you own, the more likely you are to be holding the same stocks and paying more in fees.

Minority Women Struggle in Retirement

"Minority Women and Retirement Income," a report released by WISER in November, found that women who are single in retirement face the highest rates of poverty — 49.2 percent of single elderly Hispanic women and 41.5 percent of single elderly Black women will live in poverty in retirement. (Over twice the rate of white women at 18.5 percent).



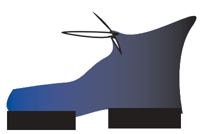
The report shows that a significant part of the deep income gap minority women face in retirement is due to the type of jobs they have held during their working years. More than half of America's minority women are employed in the service and caregiving sector — where wages are low and benefits like pensions are minimal at best.

WISER is working to make changes in the nation's retirement laws and enact retirement programs to help all older women. Some of those changes include:

- Enacting initiatives to increase pension coverage for lower-wage, part-time and temporary workers.
- Providing better financial planning including planning for contingencies such as death and divorce.
- Providing women with Social Security earning credits for caregiving.
- Providing education for those eligible for the Saver's Tax Credit.
- Increasing funding for Individual Development Accounts for retirement

For the full report, Minority Women and Retirement Income *visit WISER's website: www.wiser.heinz.org or call (202) 393-5452 for information on ordering copies, available at $5.00 each for shipping and handling.*

Younger Women: Well-Heeled, But Not Well-Invested



Analysts who predict improvement in the future of women's retirement income usually assume that younger women have more money savvy than older generations.

However, research shows that the women of "Generation X" are more likely to invest in a pair of $500 shoes than their financial future. While younger women are aware of their financial challenges, they are more likely to carry higher debt than men (credit cards and student loans), and tend to spend rather than save their income for the future.

Fortune Magazine calls it getting "genwrecked," so the answer for today's younger women is the same as for their mothers and older sisters: save for the future as soon as you can, hold off on your buying and get invested instead in a mutual fund! Someday, you'll be glad you did. Check out WISER's website at www.wiser.Heinz.org or consult Beth Kobliner's book, *Get a Financial Life* for tips geared toward those in their 20's and 30's.

Follow Up: Check Your Credit Rating

Give yourself a fresh start this year, by checking your credit rating with the three credit bureaus (Equifax, TransUnion, and Experian). The Consumer Federation of America has found that more than 40 million consumers could be penalized for inaccurate and incomplete information contained in their credit reports. These mistakes can be expensive as they can affect the interest rates you receive for mortgages or other loans. They suggest:

- Make sure nothing is missing or in error in your report.
- If you discover errors or omissions contact the reporting agency in writing to correct it.
- Demand detailed reasons for a low credit score.

Protect yourself by contacting the three credit bureaus to verify your information.

Equifax 800 685-1111
Trans Union 800 888-4213
Experian 888 397-3742

Credit Tip

Consider this: **When paying off credit card debt, sooner is better than later**. Here's why: the interest on your credit debt is calculated daily, and so if you pay as soon as you receive your bill instead of waiting, you'll pay off more of your principal debt instead of just paying down the interest.

Caregiver Resources

Caregivers looking for resources to ease the transition between hospital and home should be interested in a pair of free booklets coauthored by Gail Gibson Hunt of the National Alliance for Caregiving (NAC) and Carole Levine, of the United Hospital Fund of New York (UHFNY).

The booklets are titled:

- "A Family Caregiver's Guide to Hospital Discharge Planning" and,
- "Hospital Discharge Planning: Helping the Family Caregivers through the Process."

They can be ordered by contacting NAC at (301) 718-8444 or go to www.caregiving.org; call UHFNY at (212) 494-0755, or visit www.uhfnyc.org. A Spanish-language version of these guides will be available this spring.

Family caregivers may also be interested in Suzanne Geffen Mintz's book *Love, Honor and Value: A Family Caregiver Speaks Out About the Choices and Challenges of Caregiving* (Sterling, VA.: Capital Books, paperback, 204 pages). Mintz, President and co-founder of the National Family Caregivers Association (NFCA) speaks with fellow caregivers and draws on her own experience taking care of her husband, Steve, who developed Multiple Sclerosis in 1974. She offers a mix of personal and professional experience that should appeal to a variety of readers.

WISER's Mission

To improve the long-term financial security of all women through education and advocacy. As the only organization to focus exclusively on the unique financial challenges that women face, WISER supports women's opportunities to secure fair pensions and adequate retirement income though research, workshops, and partnerships.

Next Issue:

Reverse Mortgages
and
Legislative Update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WISER Special Report
Education Savings Accounts Vs 529 College Savings Plans

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