Chapter 1

Definition and Structure of a Mutual Fund

The concept underlying a *mutual fund* has probably existed since securities were created. In its simplest form, it works as follows. A group of individuals, with a similar *investment objective* or goal, place their investment monies into a common pool. These funds are then used to buy and sell securities. By pooling their funds, the participants reap two primary benefits. The first benefit is greater buying power. The collective buying power of the group's pooled resources enables it to purchase shares in a broader range of industries or business sectors than any individual in the pool could. The second benefit is lower transaction costs per participant. Because the commissions and other trading fees are spread over more shares, the cost per person is much lower than it would be if each individual had bought the same stocks or bonds directly through a broker.

mutual fund
commonly used name for an open-end management company that establishes a portfolio of securities and then continually issues new shares and redeems old shares representing ownership in the portfolio.

investment objective
the method by which an investor wishes to increase the value of his or her assets.

Originally, one person, usually a contributor to the pool, was designated by power of attorney or other legal means to select which securities to buy and sell. Each person in the pool shared in the gains and losses on the investments. The percentage of gains and losses was equal to the percentage of each person's participation in the pool.

These loosely run and unregulated pools were especially popular in the United States during the *bull market*

bull market
a period during which the overall prices of securities are rising.

investment company
generic name for one of the many companies, like a mutual fund, whose primary business is investing and reinvesting in securities.

Investment Company Act of 1940
the federal legislation that defines the types of organizations that qualify as investment companies and requires them to register with the SEC.

of the 1920s. In March 1924, Massachusetts Financial Services created the first true mutual fund in the United States. It was called the Massachusetts Investors Trust. Following the market crash of 1929, Congress passed legislation designed to give clearer structure to and better regulate the various types of investment pools (also called *investment companies*). The *Investment Company Act of 1940* was the first U.S. law to give mutual funds a legal definition.

One of the types of investment companies defined in the act is a management company. It is a corporation or trust whose primary business purpose is to invest and reinvest in securities in accordance with a stated investment objective. The securities that a management company's professional adviser buys and sells make up the company's investment portfolio. When an individual buys shares of a management company, he or she is, in reality, buying an undivided interest in the portfolio created by the company.

When a management company is formed, it will have either a closed-end structure or an open-end structure. (See Figure 1.1.) The basic difference between the two forms is how frequently new shares are issued to the public. A closed-end management company creates an investment portfolio and then issues shares backed by that portfolio to the public only once. Therefore, the number of shares outstanding, called the company's capitalization—the total number of shares outstanding—remains relatively fixed. (This is discussed in more detail at the end of this

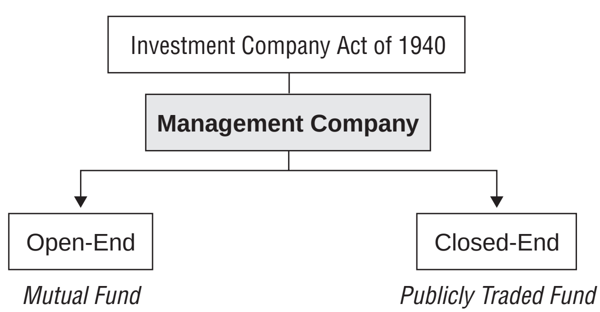

FIGURE 1.1 Types of management companies. The Investment Company Act of 1940 defines two types of management companies: open-end and closed-end.

chapter.) An *open-end management company* also creates a portfolio of securities and then issues shares to the public backed by that portfolio. In contrast, however, this company continually issues new shares and buys back old shares each business day in direct response to investors' orders to place more of their money into or pull money out of the underlying portfolio. The number of shares outstanding—its capitalization—changes continually. An open-end management company is the legal name for what is popularly called a mutual fund.

open-end management company
legal name for a mutual fund under the Investment Company Act of 1940.

MUTUAL FUND (aka Open-end Management Company)

Each mutual fund is legally registered as a separate management company or trust with the Securities and Exchange Commission (SEC). The entity that creates a fund is called the *sponsor.* It invests its own money to start the fund's portfolio. (The minimum dollar amount that the sponsor must contribute is specified in the Investment Company Act of 1940.) It also initially selects the fund's portfolio manager. The sponsor then seeks to bring additional money into the fund by marketing it to the public. The more shares it sells, the more money it has to invest in *stocks* and/or *bonds*.

sponsor
the corporation or trust that creates a mutual fund or a family of mutual funds.

stock
a negotiable security representing ownership of a company and entitling its owner to the right to receive dividends.

A mutual fund is called an "open-end" management company because it stands ready to issue new shares and redeem old shares every business day. As individuals buy (i.e., invest more money in) a fund, it issues more shares and uses the proceeds to purchase additional stocks and bonds to put into the portfolio. When investors sell (i.e., redeem) shares of a fund, the fund itself buys the shares back from the investor. Hence, the total shares outstanding declines. Thus, the number of a mutual fund's shares outstanding changes daily depending on the number of purchases or *redemptions*. Even when a mutual fund closes to new investors, those people who already have money invested in the fund can continue to buy and redeem shares.

Mutual fund shares do not trade on a stock exchange or in the over-the-counter (OTC) market. In fact, the National Association of Securities Dealers (NASD) expressly prohibits trading these shares in these *secondary markets*.

bond
a long-term debt security or IOU issued by a corporation, municipality, or government that promises to pay interest periodically and to repay the bond's principal at maturity.

redemption
the sale of mutual fund shares back to the fund or its selling agents at the fund's NAV.

secondary market
also called the aftermarket market, a collective term for the markets—exchange and OTC—in which securities trade after they are issued to the public.

It is therefore inaccurate to describe mutual funds as tradable securities. Investors cannot buy and sell shares among themselves. Instead, mutual funds are redeemable securities. An investor can only buy shares from or redeem them with the fund or through one of its authorized sales agents. Redeeming mutual fund shares is widely referred to as selling fund shares.

The emergence of *mutual fund supermarkets,* like Charles Schwab's OneSource or Fidelity's FundsNetwork, has led some people to presume that they are actually trading mutual fund shares with other investors who have accounts at these companies. This belief is wrong. Schwab, Fidelity, and other supermarket creators are authorized sales agents for these funds, in addition to selling their own funds. What many investors misconstrue as trading in a supermarket is nothing more than a purchase and a redemption, with the supermarket creator acting as an *agent*, forwarding the order to the appropriate mutual fund company. Again, there is no secondary market trading of mutual fund shares.

STRUCTURE OF A MUTUAL FUND

Understanding the organization of a mutual fund and the responsibilities of each of its components makes clear two important features: (1) the many costs associated with its day-to-day operation, and (2) the safeguards and separation of responsibilities designed to give certain entities and individuals the responsibility to act as a watchdog for investors and thus protect their interests. This last feature does not imply that investors' shares are protected from market price fluctuations. Instead, it means that the fund's assets are protected from inappropriate activities by portfolio managers. Figure 1.2 illustrates the various entities involved in a mutual fund. The specific responsibilities and duties of each are detailed next.

Sponsor

A sponsor is a company—typically a financial services organization such as a mutual fund company, brokerage

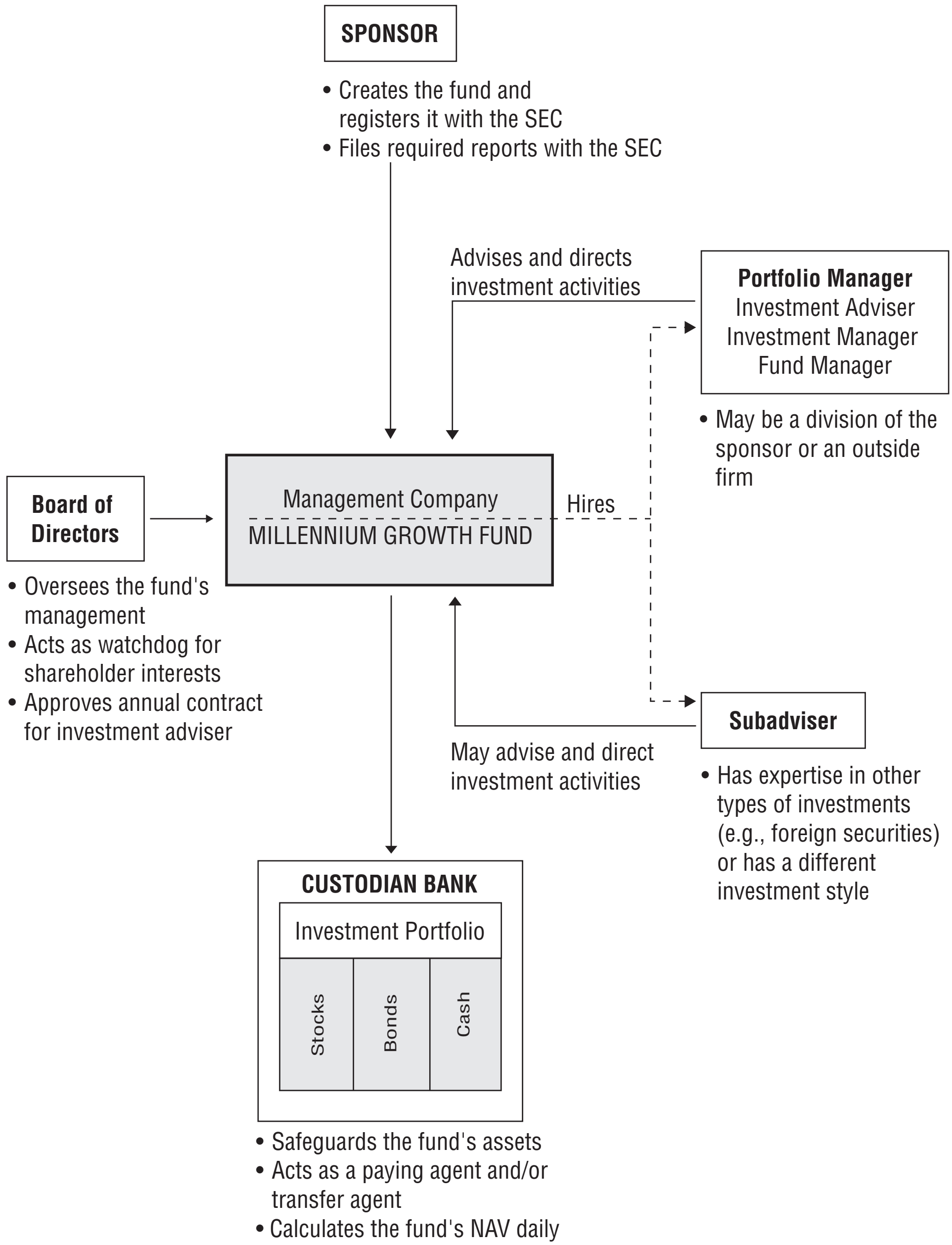

FIGURE 1.2 Structure of a typical mutual fund and the basic responsibilities of the various parties.

mutual fund supermarket a select group of mutual funds from many different sponsors that can be bought and sold through one brokerage at nominal transaction fees.

agent a registered person or business organization that acts as the intermediary in the purchase or sale of a security.

firm, bank, or insurance company—that creates and makes the first investment in a particular mutual fund or series of mutual funds. For each new fund, the sponsor must file a registration statement with the SEC and also with the appropriate authority in any state in which it plans to sell the fund. This registration document, which will become the *prospectus* for the mutual fund, must contain full and fair disclosure about the fund's sponsor, board of directors, investment objectives, types of investments permitted, fees, and risks.

Registration does not mean or imply in any way that the SEC or a state authority has approved or endorsed the mutual fund. In fact, all mutual fund prospectuses must contain the following statement in bold:

> Like all mutual fund shares, these securities have not been approved or disapproved by the Securities and Exchange Commission or any state securities commission, nor has the Securities and Exchange Commission or any state securities commission passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

Management Company

Each mutual fund is a separate open-end management company that the sponsor must register with the Securities and Exchange Commission when it is created. For example, Fidelity's Magellan Fund is an open-end management company and Vanguard's Wellington Fund is an open-end management company.

When a sponsor creates several mutual funds, it may choose to place them all under one umbrella. Such a grouping is called a *family of funds*. A family of funds may consist of as few as three mutual funds—a stock fund, a bond fund, and a money market fund. Other companies—Fidelity for example—create large fund families that include mutual funds that invest in specific industries, countries, and combinations of securities, and have different investment approaches and risk-to-reward characteristics.

Usually the shareholder services and benefits that apply to one fund apply to all funds in the same family. Sponsors view this grouping of different management companies as a way of being able to capture a larger percentage of their customers' investment dollars as they seek to diversify their holdings or as their investment objectives or economic circumstances change.

prospectus
a printed summary of the SEC-filed registration statement that discloses the details of a particular mutual fund's objective, historical performance, portfolio composition, and other information an investor can use to judge the merits of investing in the fund.

Board of Directors

The board of directors of a mutual fund is responsible for overseeing the day-to-day management of the fund as well as the trading activities of its portfolio manager or managers. More specifically, the board decides whether to renew the investment adviser's annual contract, votes on any changes in the fees the manager charges the fund, monitors the specific investments within the portfolio to avoid undue concentration in any one sector or company, and makes sure the adviser's investments comply with (and do not stray from) the fund's stated investment objectives. The primary purpose of all of the board's responsibilities is to protect the interests of the fund's shareholders.

family of funds
a group of mutual funds created by the same sponsor with different investment objectives or with portfolios of different securities.

The members of the board are initially appointed by the fund's sponsor. Afterward, they are elected by the fund's shareholders. *Proxies* are distributed annually and are used by shareholders to vote. To prevent the sponsor, who may have large amounts of money invested in the fund, from having undue influence over the board, the Investment Company Act of 1940 mandates that although 60 percent of the board can come from the sponsor, at least 40 percent must be disinterested persons. These independent directors must be individuals with no affiliation with the sponsor. In reality, these percentages still give the sponsor considerable sway over the management of the fund. In many cases, the chairman of the board of directors is the same person who is the chief executive officer (CEO) of the sponsor. Other board members typically include individuals from the fund's law firm, its accounting firm, and the trading firm that executes its buy and sell orders.

proxy
a form on which an investor votes. Shareholders can also vote via the Internet or phone.

The members of the board of directors earn fees that are disclosed in the prospectus. It has become a widespread practice for individuals to serve on the boards of several funds, especially if those funds are sponsored by the same company. For example, if you look at the prospectuses for certain mutual fund groups, you discover that many names appear again and again on the boards of a number of different funds.

Due to this overlap of directors, some shareholder activists and regulators are seeking to make changes in the composition of mutual fund boards. They argue that the large percentage of nonindependent directors results in their merely rubber-stamping the portfolio manager's activities, offering little oversight or expertise, and devoting less time than their compensation warrants. Activists and regulators also question whether the nonindependent board members, who already earn fees working for a mutual fund or mutual fund company, should also "double-dip" by earning additional fees to serve as board members. Two important changes to a fund's board of directors are currently being discussed. The first would be to increase the required percentage of independent board members (currently set at 40 percent). Since these members are appointed specifically to watch out for the interests of the fund's shareholders, then the more of them on the board the greater the possibility that the shareholders' point of view would have greater representation during any conflicts with the fund manager or sponsor. The second change would be to review board members' compensation to see if it is excessive, perhaps resulting in less careful oversight of the fees charged by the portfolio manager.

Many mutual funds already appoint a number of independent board members in excess of the percentage required under the Investment Company Act of 1940.

Investment Adviser/Investment Manager/ Portfolio Manager/Fund Manager

Generally, when people hear the terms investment adviser or portfolio manager, they think of an individual who works directly for the sponsor or the management company. In reality, an adviser is generally a corporation that is a wholly owned subsidiary of the sponsor or an outside investment advisory company. This is particularly true at the larger mutual fund companies, such as Fidelity, T. Rowe Price, and Vanguard. The person or team that is portfolio manager is therefore employed by the investment advisory firm.

An investment adviser is responsible for implementing the mutual fund's investment strategy by researching and selecting the specific securities that will be bought and sold in the portfolio. This individual or team manages the fund in accordance with the investment objective stated in the fund's prospectus, and must also abide by any restrictions regarding the types of investments that can and cannot be traded in the portfolio. These restrictions are detailed in the prospectus.

The organization of the people within the investment advisory firm varies. At some firms, a portfolio manager works autonomously handling only one fund. At others, an individual portfolio manager is responsible for two or more mutual funds within the same sector or related sectors (e.g., regional banking and financial institutions) or with complementary investment objectives. When a team of managers is responsible for a mutual fund, usually one or two are designated as team leaders or lead managers. These leaders are usually senior persons who supervise the activities of junior managers (relatively recent business school graduates) and sometimes researchers or analysts. The managers and/or the analysts may visit many of the companies in which they want to invest. They may also use computer technology to create models of the security's potential growth. This arrangement is common throughout the mutual fund industry. At companies with formal training and development programs, recently graduated professionals work with experienced managers in order to learn the business. This arrangement also enables the company to assess the individual's potential skill as a portfolio manager before assigning a fund to him or her.

The fund can also hire subadvisers. These outside investment advisory companies provide expertise in areas that the portfolio manager may not have, such as emerging markets, international bonds, or certain industry sectors (e.g., precious metals, biotechnology, etc.).

They may also provide additional research and information that the managers can use in making their investment decisions.

Each investment manager's professional experience must be disclosed in the prospectus in a section describing the fund's management services. Here, an investor is told how long the sole manager or investment team has been in charge of that fund, all funds each manager has previously run, and each manager's education. This is important information to read, particularly if you are investing in an *actively managed mutual fund*. First, you can use it to determine what period of the fund's performance has been under the direction of that specific individual or team. Second, if the adviser has managed another mutual fund previously, it enables you to research the performance of that fund during that manager's tenure. Finally, and perhaps most importantly, you can use this information to determine the manager's depth of experience in the investment markets. Has he or she experienced both bull and *bear markets*? What returns did he or she produce during these periods relative to the overall stock or bond market? All of this information will help you to judge the expertise and talent of the manager or management team before you invest.

The longer a manager or an investment team has been in charge of a mutual fund, the better. When a new or young manager takes charge of a fund, or there are management changes due to a merger or acquisition between mutual fund companies, future performance becomes even more uncertain. You should look for an experienced adviser with a proven track record of producing consistent results in good times and bad. The value of experience, tenure, and consistency should not be underestimated.

Mutual fund companies have become aware of the trust that these attributes can garner for the specific fund and its sponsor. In reaction, funds have begun to publicize successful portfolio managers in their promotional materials, advertisements, and *annual reports*. This emerging "star system" is a double-edged sword. While it increases trust and cash inflows to the fund, it can backfire if the star portfolio manager leaves the fund. Investors

actively managed mutual fund
a fund that has a portfolio manager who decides which securities should be bought into and sold out of the fund's portfolio.

bear market
a period during which the overall prices of securities are declining.

annual report
a document containing audited financial statements as well as other information about the fund's performance that each fund must distribute to shareholders annually.

might redeem their shares in the old fund and follow the manager to his or her new fund. While the old childhood rhyme "Hitch your wagon to a star and it will take you very far" might seem applicable, it is prudent for mutual fund investors to keep in mind that few portfolio managers make all investment decisions completely on their own. There are analysts and researchers at the management company supporting these activities. For example, it is usually the analysts or even the fund's senior management who determine the fund's *asset allocation*—how much of its assets should be held in stocks, bonds, and cash. When a star manager leaves, it does not necessarily mean that the performance of a mutual fund will decline. There may be a great understudy trained and waiting to step into the role.

asset allocation
the systematic and thoughtful placement of investment dollars into stocks, bonds, and cash equivalents.

An investment advisory firm earns a management fee for its services. The specific individuals who manage the fund usually receive a base salary plus a bonus based on the fund's total return. The management fee is an annual fee based on the total amount of assets under management, and is deducted from the fund a little each day. (Management fees are discussed in more detail in Chapter 3, "Fees and Expenses.")

Custodian Bank

The Investment Company Act of 1940 requires every mutual fund to appoint a qualified *custodian bank* or other entity whose primary responsibility is to safeguard the fund's assets. It holds the securities and cash resulting from the portfolio manager's trading activities. This is one of the important protective features built into a mutual fund's structure. The portfolio manager does not and cannot have possession of the fund's assets. As a result, he or she cannot abscond with them. Even if the management company were to be dissolved, the fund's assets would be at the bank where they could be liquidated and the proceeds distributed to the shareholders. Additional protection comes from the requirement that the bank must segregate the fund's assets from other bank assets. This safeguards the mutual fund's assets should the custodian go bankrupt.

custodian bank
the bank or trust company whose primary responsibility is safeguarding the fund's assets.

transfer agent
usually a commercial bank or trust company appointed by a mutual fund to keep track of daily purchases and sales of fund shares.

registrar
usually a commercial bank or trust company responsible for maintaining an accurate list of the names and addresses of a mutual fund's shareholders.

dividend
that portion of the company's after-tax earnings that its board of directors decides to distribute to the shareholders.

One key responsibility of the bank is to calculate the fund's net asset value (NAV) every business day and distribute this information to the public. The custodian bank may have other functions as well. It can act as the fund's *transfer agent,* keeping track of how many shares each shareholder owns. It can also act as *registrar,* maintaining a current and accurate list of the shareholders of the fund. This record is used for sending distributions (*dividends* and *capital gains*) as well as mailing reports, proxies, and other communications to shareholders. The custodian bank earns a custodial fee. The amount is disclosed in the prospectus.

The custodian bank is usually an outside bank or trust company. However, it may be a division of the mutual fund's sponsor.

Transfer Agent

While many mutual funds' custodian banks also act as transfer agents, other funds hire an outside organization to handle the same functions. A transfer agent is the primary record keeper and information distributor for a fund. It keeps detailed records of shareholders' accounts, including calculating, distributing, and reinvesting dividends. The agent sends a transaction *confirmation* to the customer for each purchase and sale and, at the end of each year, is responsible for mailing federal income tax information. A transfer agent prepares and mails shareholder monthly or quarterly account *statements.* It also runs the mutual fund's customer service department. This area provides account information and answers shareholder questions.

Distributor/Underwriter

The *distributor* or *underwriter* is responsible for selling the mutual fund shares to the public. To accomplish this, the distributor prepares sales literature, brochures, and advertising, and may even hold contests and promotions to give brokers an incentive to sell the fund's shares. A mutual fund distributor can also act as a retailer, selling its shares directly to the public itself. Most of the major brokerage firms create their own mutual funds. These are called *proprietary funds*. They are sold directly to the public by the brokerage firm. Prudential, Merrill Lynch, and Fidelity, for example, all act as their own retailers (Figure 1.3). However, many proprietary funds are now being sold through other sources, such as mutual fund supermarkets. The reason for the change is the supermarkets' larger client base. The proprietary funds are therefore marketed to a broader range of investors and have access to their investment dollars. The result could be an increase in assets under management and greater fees for the sponsor.

The distributor can also act as a wholesaler (Figure 1.4). In this case, the fund signs up *selling groups* through which it sells its funds. Putnam funds are a good example of this. You can buy them through just about every bank, insurance company, brokerage firm, or mutual fund supermarket. These financial institutions act as a selling group. They receive a selling concession when their customers purchase one of the Putnam funds. In acting as its own retailer and wholesaler, a fund distributor is able to offer its shares to the broadest range of investors.

A selling group member is prohibited from "warehousing" mutual fund shares. This means it cannot maintain an inventory of shares in anticipation of its customers placing orders. When you place an order to buy Putnam fund shares through Chase Investor Services

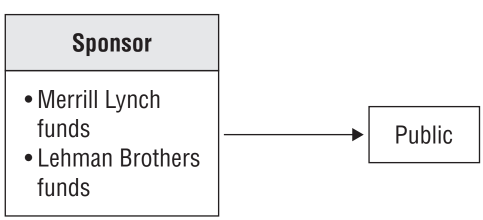

FIGURE 1.3 Retail distribution mechanism of mutual fund shares. The sponsor acts as a retailer, selling its own mutual fund shares directly to the public. Until recently, proprietary funds created by brokerage firms could only be bought and redeemed directly with the sponsor.

capital gain
the profit that results when the proceeds from the sale of a security are higher than price at which the security was purchased.

confirmation
a notice sent from the broker to the customer that discloses the details of the execution of an order, including the execution price, number of shares, settlement date.

statement
a summary of all transactions in an investor's account as well as the current value of all securities positions being held in the account.

distributor
the financial institution through which a mutual fund sells its shares to the public.

proprietary funds
a mutual fund company's own funds that it creates and sells itself.

selling group
a group of registered broker/dealers responsible for offering and selling mutual funds created by other sponsors to the public.

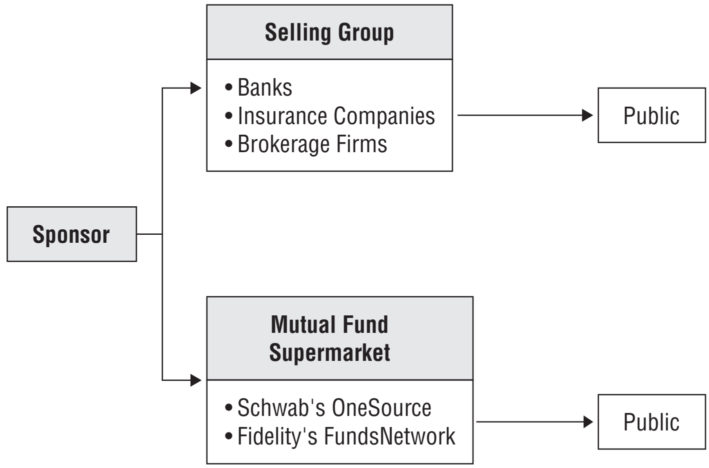

FIGURE 1.4 Wholesale distribution mechanism of mutual fund shares. The sponsor acts as a wholesaler, offering its funds' shares through individual selling group members or mutual fund supermarkets. This distribution method has become the most popular because the fund's sponsor gains access to a broader customer base to which its funds can be sold. The sponsor that sells its funds through selling groups can (and does) sell its own funds directly to the public.

(CIS), for example, CIS forwards your order to Putnam, which executes the order to buy fund shares or redeem fund shares. Hence, a selling group member can only place an order to fill an existing customer order.

CLOSED-END FUND (aka Closed-end Management Company)

Also called a publicly traded fund, a *closed-end fund* establishes a portfolio of securities, then issues shares to the public backed by the underlying portfolio. Like a mutual fund, each share represents an undivided interest in the portfolio of securities. However, a closed-end fund typically issues shares to the public only once. It does *not* continually issue new shares or redeem already outstanding shares. Therefore, unlike a mutual fund, the number of closed-end fund shares outstanding remains relatively fixed.

Just like the common shares issued by a publicly held corporation (e.g., IBM, GE, AT&T), a closed-end fund's shares can be bought and sold on a stock exchanges or in the over-the-counter market—hence the name "publicly traded fund." These shares are described as being tradable securities. In contrast, mutual fund shares (i.e., shares of an open-end management company) are redeemable securities and cannot be traded in the secondary markets.

Historically, most closed-end funds have invested in the stocks or bonds of foreign countries or of specialized sectors (e.g., municipal securities, utilities). The closed-end fund structure was chosen by the management company because the securities in the portfolio tended to lack the *liquidity* of those traded on major stock exchanges. If investors bought the securities directly, they might find it difficult to liquidate their holdings during market downturns. Because closed-end fund shares trade on an exchange (a market that is highly liquid), it is easier for U.S. investors to buy and sell them.

The following example illustrates how a closed-end fund is established and how its shares trade. Suppose a brokerage firm determines that individuals are interested in investing in growth companies whose shares trade in India. It buys shares of companies traded on the local stock exchange or exchanges of India, creating a portfolio that it then registers with the SEC. Usually the portfolio or fund would be named after the country or region where the shares were purchased. Our theoretical fund will be called the India Growth Fund. Once the fund issues shares to the public, they then trade on the New York Stock Exchange (NYSE). As with any publicly traded company, closed-end fund shares are issued at an initial public offering (IPO) price. This initial price is based on the value of the equity or debt securities in the portfolio, plus any fees that the underwriter builds into the price. At the end of each trading day the creator of the fund must compute the actual value of all the shares in the portfolio based on their closing prices in the local market—in this case, India. This value is divided by the number of outstanding fund shares to compute the funds net asset value (NAV) per share.

Once the India Growth Fund's shares are issued, their market value fluctuates daily based on expectations

closed-end fund
a type of management company that creates a portfolio of securities and then issues a fixed or limited number of shares to the public backed by the portfolio. The shares trade on the exchange or OTC markets.

liquidity
the ease with which a security can be bought or sold.

of the performance of the companies whose shares make up the underlying portfolio. The fund's shares on the NYSE may trade at a price equal to the net asset value (NAV) of the shares in the portfolio, at a discount to the NAV, or at a premium to the NAV. Investors in the closed-end fund can place orders with their brokers to buy or sell the fund's shares at any time during the trading day. A closed-end fund's shares are subject to the rules of the U.S. exchange where they are traded. However, the companies' shares in the portfolio are under the jurisdiction of the rules of the foreign markets in which they trade.

Closed-end funds enable the investment manager to maintain the portfolio, while at the same time giving investors a way to buy or sell their shares in the secondary markets. If there were a huge downturn in that particular market or sector, the manager would not be forced to liquidate the portfolio during unfavorable conditions. As investors sell the fund's shares, their market value would be driven down, perhaps trading at a deep discount to the NAV of the securities in the portfolio. In contrast, the manager of a mutual fund might be forced to liquidate positions in the portfolio if the number of redemptions resulting from the market's downturn was high.

municipal bond
a debt security issued by a city, town, state, political subdivision, or territory of the United States whose interest income is exempt from federal taxes.

Today, closed-end funds are not limited to equity securities. Many of them are bond funds, particularly *municipal bonds*. Each Monday, *The Wall Street Journal* publishes a list of closed-end funds near the end of Section C. The excerpt from this column in Figure 1.5 shows that many of the funds trade at a discount to their NAV. This discount reflects, among other factors, the reality that many closed-end fund portfolios consist of illiquid securities. If the fund had to sell them all at one time, it is virtually certain that the size of the sale would substantially decrease the securities' market value. Hence the securities would be sold at low prices—well below their market value when the sale began.

The prevailing wisdom is that it is best to buy a closed-end fund when it is trading at a deep discount to the fund's NAV. The reasoning is that if you hold the shares over a long period of time, the price should eventually

CLOSED-END FUNDS

Friday, October 23, 1998

Closed-end funds sell a limited number of shares and invest the proceeds in securities. Unlike open-end funds, closed-ends generally do not buy their shares back from investors who wish to cash in their holdings. Instead, fund shares trade on a stock exchange. The following list, provided by Lipper Analytical Services, shows the ticker symbol and exchange where each fund trades (A: American; C: Chicago; N: NYSE; O: Nasdaq; T: Toronto; z: does not trade on an exchange). The data also include the fund's most recent net asset value, its closing share price on the day NAV was calculated, and the percentage difference between the market price and the NAV (often called the premium or discount). For equity funds, the final column provides 52-week returns based on market prices plus dividends. For bond funds, the final column shows the past 12 months' income distributions as a percentage of the current market price. Footnotes appear after a fund's name. a: the NAV and market price are ex dividend. b: the NAV is fully diluted. c: NAV, market price and premium or discount are as of Thursday's close. d: NAV, market price and premium or discount are as of Wednesday's close. e: NAV assumes rights offering is fully subscribed. v: NAV is converted at the commercial Rand rate. w: Convertible Note-NAV (not market) conversion value. y: NAV and market price are in Canadian dollars. All other footnotes refer to unusual circumstances; explanations for those that appear can be found at the bottom of this list. N/A signifies that the information is not available or not applicable.

Fund Name (Symbol)	Stock Exch	NAV	Market Price	Prem /Disc	52 week Market Return
General Equity Funds					
Adams Express (ADX)	♣N	29.14	24 1/8	− 17.2	38.1
Alliance All-Mkt (AMO)	N	32.52	34 7/8	+ 7.2	76.0
Avalon Capital (MIST)	O	16.21	17 3/8	+ 7.2	43.5
Baker Fentress (BKF)	♣N	20.21	16 7/16	− 18.7	24.4
Bergstrom Cap (BEM)	A	159.00	138 1/4	− 13.1	35.0
Blue Chip Value (BLU)-ah	♣N	9.05	8 5/8	− 4.7	44.3
Central Secs (CET)	A	25.86	20 7/8	− 19.3	23.9
Corp Renaissance (CREN)-c	O	8.44	5 13/16	− 31.1	−6.7
Engex (EGX)	A	8.65	7 1/8	− 17.6	−11.1
Equus II (EQS)	♣N	24.75	16 1/2	− 33.3	58.2
Gabelli Equity (GAB)	N	10.28	10 3/16	− 0.9	39.8
General American (GAM)	♣N	32.51	29	− 10.8	38.2
Specialized Equity Funds					
C&S Realty (RIF)	♣A	8.89	10 1/16	+ 13.2	8.1
C&S Total Rtn (RFI)-a	♣N	14.24	14 1/16	− 1.2	15.9
Chartwell D & I (CWF)-a	N	13.35	14 1/2	+ 8.6	N/A
Delaware Gr Div (DDF)-a	N	15.41	17 1/16	+ 10.7	23.6
Delaware Grp Gl (DGF)-a	N	14.81	13 9/16	− 8.4	18.2
Duff&Ph Util Inc (DNP)	N	10.06	11 1/16	+ 10.0	24.1
Emer Mkts Infra (EMG)	♣N	8.76	6 9/16	− 25.1	−5.4
Emer Mkts Tel (ETF)	♣N	11.60	8 15/16	− 23.0	3.9
First Financial (FF)	N	11.08	12 1/4	+ 10.6	34.0
Gabelli Gl Media (GGT)	N	9.89	8 7/16	− 14.7	52.4
Preferred Stock Funds					
J Han Pat Pref (PPF)	♣N	14.21	14 5/16	+ 0.7	15.7
J Han Pat Prm (PDF)-a	♣N	10.75	9 7/8	− 8.1	14.0
J Han Pat Prm II (PDT)	♣N	13.52	12 3/16	− 9.9	17.9
Preferred Inc Op (PFO)	♣N	13.55	12 3/4	− 5.9	17.8
Preferred IncMgt (PFM)	♣N	16.15	14 1/8	− 12.5	13.5
Preferred Income (PFD)	♣N	16.48	15 15/16	− 3.3	16.7
Putnam Divd Inc (PDI)-a	N	11.65	10 13/16	− 7.2	15.8
Convertible Sec's. Funds					
Bancroft Conv (BCV)	♣A	25.99	23 1/4	− 10.5	36.5
Castle Conv (CVF)	A	24.59	22 15/16	− 6.7	15.3
Ellsworth Conv (ECF)	♣A	11.11	9 13/16	− 11.7	37.1
Gabelli Conv Sec (GCV)	N	10.62	10 1/4	− 3.5	20.1
Lincoln Conv (LNV)-ac	♣N	14.11	13 9/16	− 3.9	14.1
Putnam Conv Opp (PCV)-a	N	22.42	21 11/16	− 3.3	24.7
Putnam Hi Inc Cv (PCF)-a	N	8.17	9 15/16	+ 21.6	20.0
TCW Conv Secs (CVT)	♣N	8.18	9 1/2	+ 16.1	13.4
VK Conv Sec (ACS)	N	20.73	18	− 13.2	21.2
World Equity Funds					
AIM Eastern Euro (GTF)	N	6.75	5 7/16	− 19.4	0.6
ASA Limited (ASA)-cv	N	20.16	22 3/8	+ 11.0	−38.5
Argentina (AF)	N	12.12	9	− 25.7	−1.0
Asia Pacific (APB)	N	7.56	6 5/16	− 16.5	−20.2
Asia Tigers (GRR)	N	7.33	6	− 18.1	−22.9
Austria (OST)	♣N	11.47	9 5/8	− 16.1	33.5
BGR Prec Metals (BPT.A)-cy	T	14.17	N/A	N/A	−38.0
Brazil (BZF)	N	18.00	12 15/16	− 28.1	−2.4
Brazilian Equity (BZL)	♣N	5.11	4 3/8	− 14.4	−13.4
Cdn Genl Inv (CGI)-y	♣T	13.63	12	− 12.0	27.7
Cdn Wrld Fd Ltd (CWF)-cy	T	5.48	3 29/32	− 28.8	2.3
Central Eur Eqty (CEE)	♣N	14.76	11 1/2	− 22.1	12.6
Central Eur Value (CRF)	N	12.26	10	− 18.4	−18.4
Centrl Fd Canada (CEF)-c	♣A	3.94	4 3/16	+ 6.3	−2.3
Chile (CH)	♣N	11.87	8 13/16	− 25.8	−17.0
China (CHN)	N	10.81	8 3/4	− 19.1	−6.4
China, Greater (GCH)	♣N	8.65	6 13/16	− 21.2	−1.6
Clemente Global (CLM)-c	N	11.50	9 3/8	− 18.5	35.9
Dessauer Glbl Eq (DGE)	N	10.88	9 1/2	− 12.7	N/A
Economic Inv Tr (EVT)-cy	T	125.97	88	− 30.1	67.2
Emer Mkts Grow (N/A)	z	37.65	N/A	N/A	N/A
Emerging Mexico (MEF)-c	N	5.68	4 3/8	− 23.0	20.6
Europe (EF)	♣N	20.51	16 7/8	− 17.7	26.4
European Warrant (EWF)-c	N	17.30	17	− 1.7	74.7
F&C Middle East (EME)-c	N	16.60	13 1/2	− 18.7	3.1
Fidelity Em Asia (FAE)	♣N	9.22	8 1/8	− 11.9	−24.7
Fidelty Ad Korea (FAK)	♣N	4.59	4 1/4	− 7.4	−35.3
First Australia (IAF)	A	7.95	6 3/16	− 22.2	−4.1
First Israel (ISL)	♣N	13.60	11	− 19.1	9.3
First Philippine (FPF)	N	5.08	5 1/8	+ 0.9	−48.9
France Growth (FRF)	N	15.86	12 3/4	− 19.6	27.4
Germany Fund (GER)	♣N	17.60	14 11/16	− 16.5	38.7
Germany, Emer (FRG)	♣N	14.55	11 15/16	− 18.0	57.0
Germany, New (GF)	♣N	18.69	14 7/8	− 20.4	32.0
Global Small Cap (GSG)	A	14.59	11 11/16	− 19.9	17.0
Growth Fd Spain (GSP)	♣N	23.19	21 1/16	− 9.2	69.7
Herzfeld Caribb (CUBA)	O	5.19	4 9/16	− 12.1	7.1
India Fund (IFN)	N	8.06	5 15/16	− 26.3	−14.0
India Growth (IGF)-d	N	10.09	7 1/16	− 30.0	−26.8
Indonesia (IF)	♣N	2.19	3 3/8	+ 54.1	−48.8
Irish Inv (IRL)	N	21.21	17 1/16	− 19.6	40.4
Italy (ITA)	N	15.83	12 1/16	− 23.8	40.6
Jakarta Growth (JGF)	N	1.83	2 1/4	+ 23.0	−58.5
Japan Equity (JEQ)	♣N	6.04	6 7/8	+ 13.8	−21.6
Japan OTC Equity (JOF)	N	4.04	4 9/16	+ 12.9	−9.5
Jardine Fl China (JFC)	♣N	7.48	5 7/8	− 21.5	−11.4
Jardine Fl India (JFI)-c	♣N	6.80	5 1/8	− 24.6	−8.7
Korea (KF)	N	6.94	7 3/8	+ 6.3	−39.7
Korea Equity (KEF)	N	2.75	2 11/16	− 2.3	−42.3
Korean Inv (KIF)	N	2.95	2 7/8	− 2.5	−35.0
Latin Am Sm Cos (LLF)	♣N	6.04	4 3/4	− 21.4	−12.0
Latin Amer Disc (LDF)	N	7.87	5 15/16	− 24.6	18.8
Latin Amer Eq (LAQ)	♣N	10.00	7 5/16	− 26.9	−6.1
Latin Amer Inv (LAM)	♣N	11.58	8 5/16	− 28.2	−7.0
Malaysia (MF)	N	2.26	3 5/8	+ 60.4	−49.6
Mexico (MXF)-c	N	14.77	10 15/16	− 25.9	13.8
Mexico Eqty&Inc (MXE)-c	N	7.49	5 3/4	− 23.2	29.5
Morgan St Africa (AFF)	N	13.58	10	− 26.4	−1.2
Morgan St Asia (APF)	N	7.89	6 7/8	− 12.9	−16.6
Morgan St Em (MSF)	N	9.31	7 3/8	− 20.8	−4.8
Morgan St India (IIF)	N	8.66	6 5/8	− 23.5	−26.7
Morgan St Russia (RNE)	N	10.77	8 3/4	− 18.8	10.9
New South Africa (NSA)	♣N	10.96	8 5/16	− 24.2	8.9
Pakistan Inv (PKF)	N	2.27	1 9/16	− 31.2	−21.6
Portugal (PGF)	♣N	22.27	17 13/16	− 20.0	61.8
ROC Taiwan (ROC)	N	7.54	6 9/16	− 13.0	9.6
Royce Global Trust (FUND)	♣O	4.88	4	− 18.0	26.7
Scud Spain & Por (IBF)	N	14.04	11 7/8	− 15.4	74.9
Scudder New Asia (SAF)	N	10.44	8 1/2	− 18.6	−10.7
Scudder New Eur (NEF)	N	21.26	16 3/4	− 21.2	35.4
Singapore (SGF)-c	♣N	6.24	6 1/16	− 2.8	−34.0
Southern Africa (SOA)	N	12.45	9 1/2	− 23.7	12.8
Spain (SNF)	N	19.75	16 1/4	− 17.7	78.4
Swiss Helvetia (SWZ)-i	♣N	18.10	14 5/8	− 19.2	56.0
Taiwan (TWN)-c	N	16.11	13 1/8	− 18.5	−3.9
Taiwan Equity (TYW)-c	♣N	11.42	8 1/2	− 25.6	26.1
Templeton China (TCH)-c	N	7.66	6 3/8	− 16.8	−31.7
Templeton Dragon (TDF)	N	10.15	8 1/8	− 20.0	−17.4
Templeton Em App (TEA)-c	N	10.10	8 1/8	− 19.6	3.3
Templeton Em Mkt (EMF)	N	12.35	11 3/4	− 4.9	−3.0
Templeton Russia (TRF)-c	N	8.02	9 1/4	+ 15.3	5.8
Templeton Vietnm (TVF)	N	7.32	5 7/8	− 19.7	−23.0
Thai (TTF)	N	3.39	6 3/16	+ 82.5	−45.7
Thai Capital (TC)	♣N	2.93	4 1/16	+ 38.7	−38.5
Third Canadian (THD)-cy	T	16.23	15	− 7.6	8.4
Turkish Inv (TKF)	N	4.59	4 1/8	− 10.1	−3.5
United Corps Ltd (UNC)-cy	T	59.25	39	− 34.2	44.3
United Kingdom (UKM)	♣N	15.29	14	− 8.4	20.5
Z-Seven (ZSEV)	O	6.47	6 1/16	− 6.3	8.3
U.S. Gov't. Bond Funds					
ACM Govt Inc (ACG)	N	8.84	8 7/8	+ 0.4	7.9
ACM Govt Oppty (AOF)	N	8.53	8	− 6.2	7.7
ACM Govt Secs (GSF)	N	8.80	8 7/16	− 4.1	8.8
ACM Govt Spec (SI)	N	7.15	6 5/16	− 11.7	8.9
Bull&Bear US Gvt Sec (BBG)	♣A	14.99	13 5/8	− 9.1	6.1
Dean Witter Govt (GVT)	♣N	9.67	8 7/8	− 8.2	6.9
Excelsior Income (EIS)-c	♣N	19.14	17 1/16	− 10.9	6.9
Kemper Int Govt (KGT)-a	♣N	7.96	7 13/16	− 1.9	8.4
MFS Govt Mkts (MGF)-a	N	7.53	6 3/4	− 10.4	7.4
RCM Strat Glbl (RCS)	N	11.47	10 1/16	− 12.3	8.9
U.S. Mortgage Bond Funds					
2002 Target Term (TTR)-ac	N	15.46	14 3/16	− 8.2	6.3
Amer Sel Port (SLA)-c	N	13.06	11 7/8	− 9.1	9.0
Amer Str Inc II (BSP)-c	N	13.21	11 7/8	− 10.1	8.4
Amer Str Inc III (CSP)-c	N	12.59	11 1/2	− 8.7	8.9
Amer Str Income (ASP)-c	N	13.03	11 15/16	− 8.4	8.0
BlckRk 1998 Term (BBT)-ac	N	10.02	9 15/16	− 0.8	5.1
BlckRk 1999 Term (BNN)-ac	N	10.05	9 11/16	− 3.6	4.2
BlckRk Tgt Tm (BTT)-ac	N	10.20	9 5/8	− 5.6	6.1
Heritage US Govt (HGA)-ac	N	12.48	10 5/8	− 14.9	8.4
Hyperion 1999 Tm (HTT)-ac	N	7.41	7 3/16	− 3.0	5.6
Hyperion 2002 Tm (HTB)-ac	N	9.25	8 3/8	− 9.5	6.0
World Income Funds					
Alliance Wld $ (AWG)	♣N	9.98	11 1/8	+ 11.5	8.8
Alliance Wld $ 2 (AWF)	N	8.35	8 7/8	+ 6.3	9.1
BlckRk North Am (BNA)-ac	N	11.82	10 3/16	− 13.8	7.8
Bull&Bear Global Inc (BBZ)-a	♣A	6.31	5 5/8	− 10.9	9.3
Dreyfus Str Govt (DSI)	♣N	10.29	9	− 12.5	12.3
Emer Mkts Float (EFL)	N	10.52	11 1/2	+ 9.3	9.0
National Muni Bond Funds					
ACM Muni Secs (AMU)	N	13.55	14 1/8	+ 4.2	6.2
Amer Muni Income (XAA)-c	N	15.35	14	− 8.8	5.6
Amer Muni Tm II (BXT)-c	N	11.68	11 7/16	− 2.1	5.4
Amer Muni Tm III (CXT)-c	N	11.60	11 3/16	− 3.6	5.1
Amer Muni Tm Tr (AXT)-c	N	11.55	11 9/16	+ 0.1	5.7
Apex Muni (APX)	N	10.71	10 5/8	− 0.8	6.1
BlckRk Ins 2008 (BRM)-a	N	17.18	16 3/16	− 5.8	5.4
BlckRk Ins Muni (BMT)-a	N	11.32	11 7/16	+ 1.0	5.6

FIGURE 1.5 Closed-end fund listing from *The Wall Street Journal.* This separate listing of "Closed-End Funds" is published in *The Wall Street Journal* each Monday. During the rest of the week, a specific fund can be found in the New York Stock Exchange, American Stock Exchange, or Nasdaq stock listings, depending on where the fund trades. (See the column heading "Stock Exch.") The listings in the section headed "World Equity Funds" are the type described in the example in the text. However, today closed-end funds invest in a variety of securities: mortgage bonds, municipal bonds, high-yield bonds, government bonds, and convertible securities. (Published with permission of *The Wall Street Journal*. Copyright © 1999 Dow Jones & Company, Inc.; permission conveyed through Copyright Clearance Center, Inc.)

rise back to the fund's NAV. This price appreciation, combined with any dividends or interest, should provide the investor with a higher-than-market rate of return. While this strategy seems simple, investing in closed-end funds requires considerable knowledge of the securities within the portfolio and the economic factors that affect them, as well as a knowledge of the factors that influence the markets in which they trade. This information may not be readily available, especially for some of the world equity funds. There are no simple, foolproof strategies.

Sometimes when a closed-end fund is selling at a deep discount to its net asset value (NAV), its board of directors and shareholders may vote to convert it to an open-end structure—a mutual fund. (It is rare for an open-end fund to convert to a closed-end fund.) At conversion, the fund's market price will now be the same as its net asset value. (Remember that a mutual fund is priced at the end of each day at its net asset value.) The difference between the discounted market price and the NAV would be a gain for holders of the once closed-end fund. Additionally, it also means that the fund can now begin to issue more shares, raising additional investment capital for the fund's portfolio.

MUTUAL FUNDS VERSUS CLOSED-END FUNDS

Although mutual funds and closed-end funds are both management companies, they are quite different products. Despite occasional mention in the financial media of a product called a "closed-end mutual fund," the definitions of a closed-end fund and an open-end fund under the Investment Company Act of 1940 make this term an oxymoron. I suspect that when this term is used, it refers to an actively managed closed-end fund. Many are not managed; therefore, such a fund's investment portfolio of securities changes little. A closed-end fund that is actively managed might resemble a mutual fund to a few people, but keep in mind that the number of outstanding shares remains fixed, unlike a mutual fund. Given current legislation, a “closed-end mutual fund” cannot exist.

Now that you understand the basic differences between the two types of funds, you probably wonder what led to the popularity of mutual funds over closed-end funds. There are probably four key reasons.

First, there are simply more mutual funds (more than 8,000) than closed-end funds (around 1,000). And they are more heavily advertised than closed-end funds. Hence, when people look at investment options, mutual funds show up and are recommended much more often.

The second reason for their popularity is the certainty of pricing. At the end of each business day a mutual fund computes and publishes the value (minus applicable fees and expenses) of each share outstanding. In contrast, the real value of a closed-end fund is less certain. Market forces could drive the value of the fund’s shares up, causing them to trade at a premium to their net asset value. Or the same forces could drive the price down, resulting in their trading at a discount. Price uncertainty is a concept that is emotionally (if not intellectually) anathema to most investors. They want to know exactly what their shares are worth.

The third reason is size. Mutual funds typically have more money to invest than do closed-end funds. Each time an investor buys a mutual fund share, the fund itself gets new money that it can use to buy more securities. These additional dollars enable it to achieve greater diversity more easily than a closed-end fund. It can purchase shares of more companies in different sectors. When a person buys a closed-end fund share on a stock exchange, the money goes to the seller of the share, not to the fund.

The final reason for mutual funds’ popularity is low initial investment cost. You can begin by investing as little as $25 a month in a fund. This makes the product available to a vast cross section of potential investors. These reasons, combined with access to professional management, largely explain why mutual funds are the investment of choice of millions of Americans. The remainder of this book will focus solely on mutual funds. Each chapter will examine particular features of a fund that you must evaluate to be able to select the mutual funds that are most suitable for your investment objectives, time horizon, and risk tolerance.