

## What is a Mutual Fund?

### Suggested Grade & Mastery Level

High School

### Suggested Time

45- 50 minutes

### Teacher Background

A mutual fund is a collection of stocks, bonds and other securities owned by a group of investors and managed by a professional investment advisory firm. The investment firm collects money from investors, pools it and invests it. The mutual fund manager, working with a team of analysts, decides which stocks and securities to include in the fund, often investing in 100 or more securities. Some mutual funds are index funds, which closely follow a particular index of stocks such as the S&P 500 or the Dow.

Mutual funds fit the needs of people with a variety of risk tolerances—from the very conservative to the more speculative. Every day the fund's managers and analysts evaluate the performance of each security and how current economic, social and political events might affect their holdings. Based on these factors, the fund manager decides which securities in the fund to keep or sell.

All mutual funds have investment objectives, for example, value funds only invest in stocks the fund's managers believe are undervalued. Some funds take the fund's objectives even further by only investing in companies the managers believe are "socially responsible". Socially responsible can mean different things to different people. For more on socially responsible funds, visit <http://www.socialfunds.com>, where you can find funds that address everything from the environment to religious standards.

Investing in mutual funds helps individual investors "diversify their portfolios." Investors cannot buy a mutual fund's shares on margin (using money borrowed from a broker to buy stock) or sell them short (sale of a stock borrowed from a broker. Short sellers believe a stock's price will drop enabling them to repay the borrowed shares with lower-priced ones).

### Vocabulary

**Bonds:** An IOU that a company or government sells when it borrows money. Bonds are called fixed-income investments because they pay a fixed amount of interest to the bondholder for the use of his/her money.

**Closed-end funds:** Like open-end mutual funds, these are collections of securities managed by a professional investment advisor. Unlike open-end mutual funds, their shares are traded on a stock exchange like ordinary stock.

**Diversification:** Reducing risk by combining different investments whose prices aren't likely to move in step with one another.

**Exchange-Traded Funds:** Funds whose shares, like closed-end funds, are traded on a stock exchange. These invest in stocks or bonds that closely follow an index.

**Index:** A statistical measure of change in an economy or a securities market. In the case of financial markets, an index is essentially an imaginary portfolio of securities representing a particular market or a portion of it. For example, the Standard & Poor's 500 is one of the world's best known indexes and is the most commonly used benchmark for the stock market.

**Mutual funds:** An investment instrument developed and managed by a company that pools members' money—often millions of dollars—to invest in a variety of stocks and bonds. Investment professionals who research companies and buy or sell stocks actively manage the funds based on what they think is best for the fund's shareholders.

**Open-end funds:** Funds that usually sell as many shares as investors want to buy. Sometimes open-end funds stop selling shares to new investors when they grow too large to be managed effectively. Investors, who want to sell shares of their open-end funds, sell them back to the mutual fund.

## Performance Objectives

Students will be able to:

- Define and identify the characteristics of a mutual fund
- Use the newspaper and Internet to research mutual funds.
- Use their research on mutual funds to help determine team investments for The Stock Market Game.
- Create and deliver a presentation on mutual funds, their risk and performance

## Subject Areas

Economics, Technology/ Research, English Language Arts (Writing), Mathematics, Business, Social Studies

## Materials

- Activity Sheet 1: What are Mutual Funds, Part I and Part II (for Master and Grand Master)
- Activity Sheet 2: Reading and Interpreting Information on Mutual Funds
- Activity Sheet 3: Selecting and Evaluating a Mutual Fund
- Chart Paper & markers
- Computers/Internet

## Springboard Activity

Have students, working in their SMG teams, brainstorm different products and services people buy and use. Have students name a range of products in these three categories:

Information (software, media, telecommunications, hardware)

Services (healthcare, consumer, business, and financial services)

Manufacturing (consumer goods, industrial materials, energy, utilities)

Explain to the students that when you are making investments, you want to diversify your portfolio.

### ASK

- As an investor, why might you want to invest in companies under all three categories?
- How many of you would invest in products in more than one of the category?
- What if you could only buy in one category?
- Would that put your money in greater risk?

## Procedure

A mutual fund company does exactly what we have just discussed. They take investors' money, pool it with other investors' money and invest in various stocks, bonds and other securities. Some mutual funds are more risky than others depending on the types of investments they make.

Organize students in their SMG teams and distribute Activity Sheet 1: What Are Mutual Funds? Part I. Have students complete the activity sheet in their teams. Discuss as a class.

**NOTE:** For more information on mutual funds, The Stock Market Game supplies information on funds and how to invest in them. When the students sign into their SMG accounts, they can click on the green tab at the top right that says "Mutual Funds."

[Novice](#) and [Apprentice](#) Levels:

Distribute Activity Sheet 2: Reading and Interpreting Information on Mutual Funds and review with the students how to read the table. Using information the teams developed on Activity Sheet 1: What Are Mutual Funds, have the teams go to [www.morningstar.com](http://www.morningstar.com) and research the three funds they selected. Use Activity Sheet 3: Selecting and Evaluating a Mutual Fund to help guide the research.

[Master](#) and [Grand Master](#) Levels:

Complete Activity Sheet 1: What Are Mutual Funds, Part 2 and discuss which mutual fund families the students would like to research further. Distribute Activity Sheet 2: Reading and Interpreting Information on Mutual Funds and review with the students how to read the table.

## Assessment

[Novice](#) and [Apprentice](#) Levels

### ASK

- Based on what you now know about mutual funds, will your team consider investing in mutual funds?
- Why or why not?

[Master](#) and [Grand Master](#) Levels:

### ASK

- Based on your research, if your team was going to invest in a mutual fund, which fund would be your primary investment?
- Why did you choose this fund?

## Application

[Novice](#) and [Apprentice](#) Levels:

Using the information the teams developed in Activity Sheet 1: What Are Mutual Funds? Have the student team go to [www.morningstar.com](http://www.morningstar.com) and research the three funds they selected. Use Activity Sheet 3: Selling and Evaluating a Mutual Fund for Novice and Apprentice Levels to guide the research.

### ASK

- How will the information you found through Internet research help you when you decide where to put your mutual fund investment dollars?

Based on your new understanding of mutual funds, what will your investment strategy be—mutual funds or individual stocks or perhaps both?

Have students each write a paragraph describing their team's investment approach.

Master and Grand Master Levels:

Use **Activity Sheet 3: Selling and Evaluating a Mutual Fund** for Master and Grand Master Levels guide the research.

### ASK

- What information does the Morningstar style box provide to help investors make their decisions?

Could you use the same system for individual stocks? Why or why not?

Hold a classroom debate, assigning some teams to support mutual fund only investing, some to support stock only investing and some to advocate a mix of stocks and mutual funds. Have each team make a three-minute presentation before the debate begins outlining their point of view.

## Enrichment Activities

Have each team select several mutual funds for possible investment. Assign each team member to research one fund under consideration and report back to the group on or before the next time the team must evaluate their portfolio. At that time, have each team make a brief presentation on one of the funds researched (they do not have to reveal their investment strategy: they can select a fund that they rejected or accepted as a potential investment).

Math: Have students create a bar graph or pie chart showing a breakdown of investments the mutual fund contains (bonds, information, services, manufacturing, gold, etc...) Encourage students to use their IT skills in creating this graph. Students may also do a comparative study of the performance of various kinds of funds—stock funds, bond funds, mixed funds, etc.