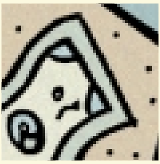
a guide to

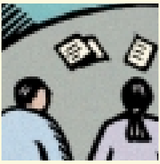
Mutual Funds

A mutual fund company is an



investment

company that pools money from



shareholders and

invests in a *diversified*

portfolio of securities.

INVESTMENT COMPANY INSTITUTE®

Table of Contents

For More Information

The Investment Company Institute is the national association of the investment company industry. The Institute's website, located at www.ici.org, is an educational and reference tool for individuals seeking information about the mutual fund industry.

What Is a Mutual Fund?

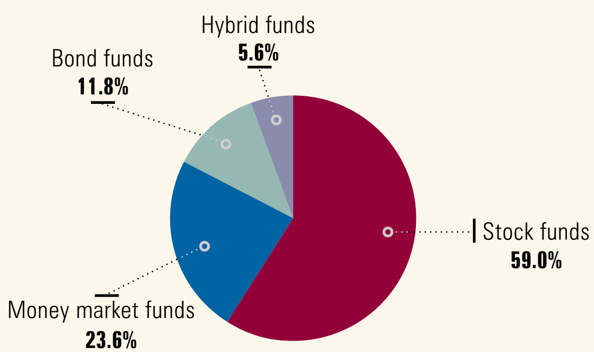
A mutual fund is an investment company that pools money from shareholders and invests in a diversified portfolio of securities. An estimated 82.8 million individual Americans in 48.4 million U.S. households own mutual fund shares.

This brochure provides an overview of the types of mutual funds and how they operate. However, each mutual fund is different, and investors should read the prospectus and learn more about a particular fund before investing.

Four Basic Types of Mutual Funds

There are four basic types of mutual funds: stock (also called equity), bond, hybrid—which invest in mix of stocks and bonds—and money market. Money market funds are referred to as short-term funds because they invest in securities that generally mature in about one year or less, whereas stock, bond, and hybrid funds are known as long-term funds. Of the total $6.843 trillion invested in mutual funds at the end of 1999, $4.039 trillion was invested in stock funds, $808.2 billion in bond funds, $383.8 billion in hybrid funds, and $1.612 trillion in money market funds.

How Mutual Fund Assets Are Invested
(yearend 1999)



An investor in a mutual fund is a shareholder who buys shares of the fund. Each share represents a proportionate ownership in all the fund's underlying securities. The securities are selected by a professional investment adviser to meet a specified financial goal, such as growth or income.

Before You Buy

You should determine your investment objectives before buying mutual fund shares—for example, you may be planning to buy a house, send your children to college, or finance your retirement. Your objectives may change as your age or income changes.

You should also think about how much risk you are comfortable with. Remember that you can lose money investing in a mutual fund, because securities making up the fund's portfolio (typically stocks and/or bonds) rise and fall in value. Furthermore, mutual funds are not guaranteed by the Federal Deposit Insurance Corporation—no matter where the fund is sold.

There is an upside to investment risk, however. It's called the risk-reward trade-off. What that means is the greater the risk, the higher the potential financial reward in terms of return on your investment.

Key Features of Mutual Funds

Professional Management

The money accumulated in a mutual fund is managed by professionals who decide on behalf of shareholders on investment strategy. These professionals choose investments that best match the fund's objectives as described in the prospectus. Their investment decisions are based on extensive knowledge and research of market conditions and the financial performance of individual companies and specific securities. As economic conditions change, the fund may adjust the mix of its investments to adopt a more aggressive or a more defensive posture to meet its investment objective.

Diversification

Fund managers typically invest in a variety of securities, seeking portfolio diversification.

A diversified portfolio helps reduce risk by offsetting losses from some securities with gains in others. The average investor would find it expensive and difficult to construct a portfolio as diversified as that of a mutual fund. Mutual funds provide an economical way for average investors to obtain the same kind of professional money management and diversification of investments that is available to large institutions and wealthy investors.

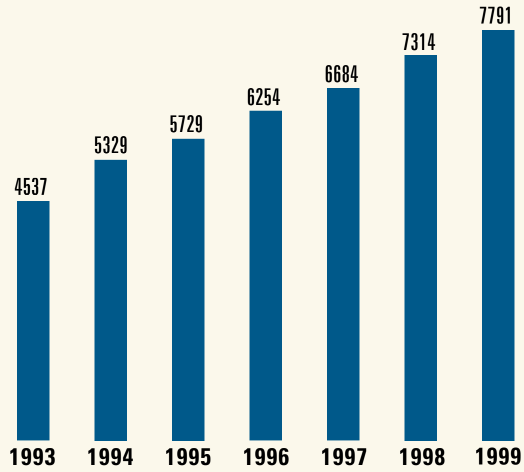
Variety

There are about 7,800 mutual funds representing a wide variety of investment objectives, from conservative to aggressive, and investing in a wide range of securities. The Investment Company Institute classifies mutual funds into 33 broad categories according to their basic investment objective. (See p.18, "Types of Mutual Funds.")

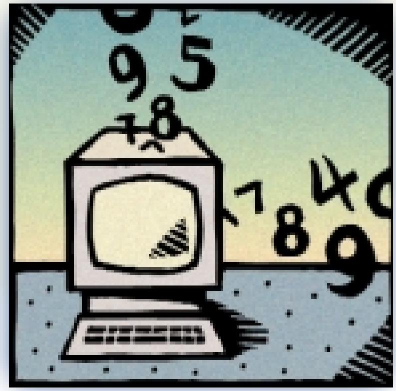
There are also specialty or sector funds that invest primarily in a specialized segment of the securities markets.

Number of Mutual Funds

(yearend)



Specialty funds include biotechnology funds, small-company growth funds, index funds, funds that invest in other mutual funds, and social criteria funds. The broad selection of funds arose over the years to meet consumer demand for fund products that help meet a variety of financial objectives.

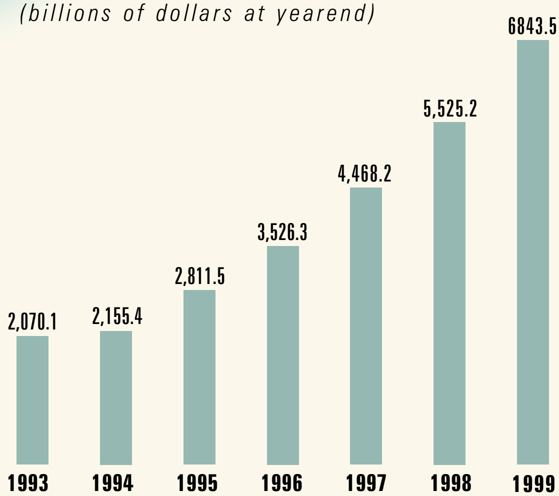


Daily Pricing

Mutual funds must calculate the price of their shares every business day. Investors can sell (redeem) some or all of their shares anytime and receive the current share price, which may be more or less than the price originally paid. The share price, called net asset value, or NAV, is the market value of all the fund's securities, minus expenses, divided by the total number of shares outstanding. The NAV changes as the values of the underlying securities rise or fall, and as the fund changes its portfolio by buying new securities or selling existing ones. Daily NAVs appear in the financial pages of most major newspapers.

When a fund earns money on its portfolio securities, it distributes the earnings to shareholders as dividends or, if the securities are sold for a profit, as capital gains. Shareholders also may elect to reinvest their dividends and capital gains in the purchase of additional fund shares. If the overall value of the securities held by a fund increases, the value of the fund's portfolio increases as well. Dividends and capital gains are paid out to the fund's shareholders in proportion to the number of shares owned. Thus, investors who put $1,000 in the fund get the same investment return per dollar as those who invest $100,000.

Assets of Mutual Funds
(billions of dollars at yearend)



Regulation and Disclosure

All U.S. funds are subject to strict regulation and oversight by the Securities and Exchange Commission (SEC). As part of this regulation, all funds must provide investors with full and complete disclosure about the fund in a written prospectus. This document describes, among other things, the fund's investment objective, its investment methods, information on how to purchase and redeem shares, information about the investment adviser, the level of risk the fund is willing to assume in pursuit of its objective, and fund fees and expenses (see page 14).

All funds are required to provide their shareholders with annual and semiannual reports that contain recent information on the fund's portfolio, performance, and investment goals and policies.

Mutual funds are regulated under four federal laws designed to protect investors. The Investment Company Act of 1940 requires all funds to register with the SEC and to meet certain operating standards; the Securities Act of 1933 mandates specific disclosures; the Securities Exchange Act of 1934 sets out antifraud rules covering the purchase and sale of fund shares; and the Investment Advisers Act of 1940 regulates fund advisers.

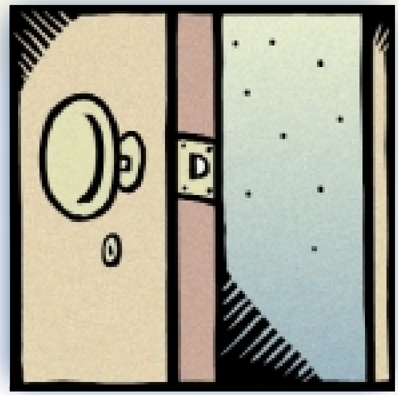
Shareholder Services

Mutual funds offer a wide variety of services to meet shareholders' needs. These services may include toll-free and 24-hour telephone access, consolidated account statements, tax information, exchanges among funds, automatic investments and withdrawals, and checkwriting privileges for some funds. Mutual funds also provide extensive investor education and shareholder communications, including websites, newsletters, brochures, and retirement and other planning guides.

Accessibility

Mutual fund shares are easy to buy. Investors (outside retirement plans) may purchase fund shares with the help of an investment professional (e.g., a broker, financial planner, bank representative, or insurance agent) or directly, based on the investor's own research and knowledge. Investment professionals provide services to investors—analyzing the client's financial needs and objectives and recommending appropriate funds. They are compensated for those services, generally through a fee for service, a sales commission, or through 12b-1 fees deducted from the fund's assets.

Direct-marketed funds are sold through the mail, by telephone, or at office locations. They typically offer fund shares to the public with a low sales charge or none at all. Funds that do not charge a sales commission are known as



"no-loads." Because direct-marketed funds do not usually offer specific investment advice, investors are required to do their own research and determine which funds meet their needs.

Mutual funds may also be offered as investment selections in 401(k) plans and other employee benefit plans.

Other Considerations

Fees and Expenses

All mutual funds have fees and expenses that are paid by investors. These costs are important because they affect the return on your investment, particularly over the long term. Before investing in a mutual fund, you should decide if the fund's costs are acceptable to you.

One way to learn about fees is to read the fund's prospectus (the document describing the fund, available free for the asking directly from the fund company or from a broker or financial planner). Every prospectus contains a fee table, which must include an example showing the dollar amount of expenses you would pay on a hypothetical $10,000 investment that earns five percent annually over 1-, 3-, 5- and 10-year periods. While the amount you invest and your rate of return are unlikely to match the example, this standardized measure can be a useful way to compare the effect of fees for different funds.

Fees generally fall into two categories—"shareholder fees" and "annual operating expenses." Shareholder fees include any commission paid to brokers when you buy or sell your shares. These commissions are often described as "front-end loads" (sales charges when you buy) or "back-end loads" (sales charges when you sell). "No-load" funds, as the name implies, do not have front-end or back-end sales charges.

Annual operating expenses pay for the ongoing costs of running a fund—for the services of the fund manager, for example, who selects and oversees the fund's portfolio of securities—and for various fund services, such as recordkeeping and printing and mailing. Annual operating expenses also may include so-called "12b-1" fees, which are fees deducted from fund assets to pay for marketing and distribution expenses, such as compensating brokers. Both shareholder fees and annual operating expenses are shown in the fee table in the fund's prospectus.

Other Considerations, *continued*

Remember, however, that fees don't tell the whole story. A fund with lower expenses may perform better than a fund with higher expenses—and the opposite may also be true. Perhaps most importantly, you should consider the fund's investment objectives, policies, and risks to make sure they mesh with your own outlook and goals. Here again, the prospectus is an important source of information.

Finally, you should remember that when a fund's returns are reported (including those in mutual fund advertisements), fees and expenses have already been deducted. For a more detailed explanation of mutual fund fees, see the Institute publication, *Frequently Asked Questions about Mutual Fund Fees,* available on the Institute's website at ici.org/pdf/mf_fee_faqs.pdf.

Taxes

In order to avoid the imposition of federal tax at the fund level, a mutual fund must meet IRS requirements for sources of income and diversification of portfolio holdings, and must distribute substantially all of its income and capital gains to shareholders annually.

Generally, shareholders of mutual funds must pay income taxes on the dividends and capital gains distributed to them. Each fund will provide an IRS Form 1099 to its shareholders annually that summarizes the fund's dividends and distributions. When a shareholder sells shares of a fund, the shareholder will realize either a taxable gain or a loss.

Types of Mutual Funds

Stock Funds

Aggressive growth funds invest primarily in common stock of small, growth companies with potential for capital appreciation.

Emerging market equity funds invest primarily in equity securities of companies based in less-developed regions of the world.

Global equity funds invest primarily in worldwide equity securities, including those of U.S. companies.

Growth and income funds attempt to combine long-term capital growth with steady income dividends. These funds pursue this goal by investing primarily in common stocks of established companies with the potential for both growth and good dividends.

Growth funds invest primarily in common stocks of well-established companies with the potential for capital appreciation. These funds' primary aim is to increase the value of their investments (capital gain) rather than generate a flow of dividends.

Income equity funds seek income by investing primarily in equity securities of companies with good dividends. Capital appreciation is not an objective.

International equity funds invest at least two-thirds of their portfolios in equity securities of companies located outside the United States.

Regional equity funds invest in equity securities of companies based in specific world regions, such as Europe, Latin America, the Pacific Region, or individual countries.

Sector equity funds seek capital appreciation by investing in companies in related fields or specific industries, such as financial services, health care, natural resources, technology, or utilities.

Bond Funds

Corporate bond–general funds seek a high level of income by investing two-thirds or more of their portfolios in corporate bonds and have no explicit restrictions on average maturity.

Corporate bond–intermediate-term funds seek a high level of income with two-thirds or more of their portfolios invested at all times in corporate bonds. Their average maturity is five to 10 years.

Corporate bond–short-term funds seek a high level of current income with two-thirds or more of their portfolios invested at all times in corporate bonds. Their average maturity is one to five years.

Global bond–general funds invest in worldwide debt securities and have no stated average maturity or an average maturity of more than five years. Up to 25 percent of their portfolios' securities (not including cash) may be invested in companies located in the United States.

Global bond–short-term funds invest in worldwide debt securities and have an average maturity of one to five years. Up to 25 percent of their portfolios' securities (not including cash) may be invested in companies located in the United States.

Government bond–general funds invest at least two-thirds of their portfolios in U.S. government securities and have no stated average maturity.

Government bond–intermediate-term funds invest at least two-thirds of their portfolios in U.S. government securities and have an average maturity of five to 10 years.

Government bond–short-term funds invest at least two-thirds of their portfolios in U.S. government securities and have an average maturity of one to five years.

High-yield funds seek a high level of current income by investing at least two-thirds of their portfolios in lower-rated corporate bonds (Baa or lower by Moody's and BBB or lower by Standard and Poor's rating services).

continued on page 20

Types of Mutual Funds, *continued*

Mortgage-backed funds invest at least two-thirds of their portfolios in pooled mortgage-backed securities.

National municipal bond–general funds invest predominantly in municipal bonds and have an average maturity of more than five years or no stated average maturity. The funds' bonds are usually exempt from federal income tax but may be taxed under state and local laws.

National municipal bond–short-term funds invest predominantly in municipal bonds and have an average maturity of one to five years. The funds' bonds are usually exempt from federal income tax but may be taxed under state and local laws.

Other world bond funds invest at least two-thirds of their portfolios in a combination of foreign government and corporate debt. Some funds in this category invest primarily in debt securities of emerging markets.

State municipal bond–general funds invest primarily in municipal bonds of a single state and have an average maturity of more than five years or no stated average maturity. The funds' bonds are exempt from federal and state income taxes for residents of that state.

State municipal bond–short-term funds invest predominantly in municipal bonds of a single state and have an average maturity of one to five years. The funds' bonds are exempt from federal and state income taxes for residents of that state.

Strategic income funds invest in a combination of domestic fixed-income securities to provide high current income.

Hybrid Funds

Asset allocation funds seek high total return by investing in a mix of equities, fixed-income securities and money market instruments. Unlike flexible portfolio funds (defined below), these funds are required to strictly maintain a precise weighting in asset classes.

Balanced funds invest in a specific mix of equity securities and bonds with the three-part objective of conserving principal, providing income, and achieving long-term growth of both principal and income.

Flexible portfolio funds seek high total return by investing in common stock, bonds and other debt securities, and money market securities. Portfolios may hold up to 100 percent of any one of these types of securities and may easily change, depending on market conditions.

Income mixed funds seek a high level of current income by investing in a variety of income-producing securities, including equities and fixed-income securities. Capital appreciation is not a primary objective.

Money Market Funds

National tax-exempt money market funds seek income not taxed by the federal government by investing in municipal securities with relatively short maturities.

State tax-exempt money market funds invest predominantly in short-term municipal obligations of a single state, which are exempt from federal and state income taxes for residents of that state.

Taxable money market–government funds invest principally in short-term U.S. Treasury obligations and other short-term financial instruments issued or guaranteed by the U.S. government, its agencies or instrumentalities.

Taxable money market–non-government funds invest in a variety of money market instruments, including certificates of deposit of large banks, commercial paper, and banker's acceptances.

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