

What Is a Mutual Fund?

ICI Explains

What Is a Mutual Fund?

Mutual funds are a popular, convenient investment option that have been offered in the United States for more than 90 years. Whether you're among the millions of households that currently use mutual funds to save for long-term financial goals, or you're considering investing in mutual funds for the first time, this brief video has basic—but important—information that may help, as ICI Economist Morris Mitler explains.

About Morris

This video is narrated by Morris Mitler, an economist in industry and financial analysis at ICI. He researches the US and global mutual fund and closed-end fund industries, and conducts economic analysis to better understand the costs, benefits, and effects of proposed laws and regulations governing mutual funds and exchange-traded funds (ETFs). He earned a BA in economics from the University of San Diego, as well as an MA in economics and an MS and PhD in finance from George Washington University.

Transcript

Hi. I'm Morris Mitler, an economist at the Investment Company Institute, and today I'd like to provide a brief overview of mutual funds.

Mutual funds are a popular, convenient investment option that have been offered in the US for more than 90 years, helping millions of households to invest and save for their long-term financial goals—including education, housing, and retirement. Some of you may already be familiar with mutual funds because they are offered as an option through a 401(k) plan or an individual retirement account [IRA]. Others of you may be considering investing in mutual funds for the first time and are looking for some additional information.

You can think of a mutual fund as a single option that offers access to a diversified pool of investments, such as stocks, bonds, or other financial assets. In exchange for a cash investment, investors receive shares in the mutual fund. These shares allow investors to participate in the financial performance of the fund's assets.

In the US, all mutual funds are registered with the Securities and Exchange Commission and are subject to oversight by the SEC. They offer daily pricing—the fund's net asset value, or NAV, is set at the end of each trading day. There are strict disclosure requirements for each fund, which ensures transparency. And each mutual fund is overseen by a board of directors, who ensure that the fund is operated in the interests of its investors.

One of the reasons that mutual funds continue to be popular investments is because they offer professional money management and

a diversified portfolio at a reasonable price. Why does this matter? Well, you can think of the concept of diversification using the old expression, “Don’t put all of your eggs in one basket.” In a diversified portfolio, you hold a mixture of assets—such as stocks, bonds, or even money market instruments.

Contrast that with a non-diversified portfolio that is invested in a single asset. Let’s say 100 percent of your portfolio is invested in the stock of a single corporation. This means that the value of your portfolio is entirely dependent on the financial performance of that one company. In a diversified portfolio, risks are spread across other assets such that negative performance in one asset can be offset by positive performance in another. This is how mutual funds can help households diversify their financial holdings.

Let’s take a look at some of the mutual funds that are offered in the marketplace today. Broadly speaking, mutual funds can be categorized according to whether they are actively managed or managed in a way that seeks to match a market index.

In an actively managed mutual fund, a person called a portfolio manager selects assets according to the fund’s investment mandate. Let’s consider an example of how this might work. If a portfolio manager expects the price of milk to increase, they may then choose to sell the bonds of companies that make ice cream—which buy milk as a component of the product they make—and use the money to invest in bonds of companies that, for example, are tied to the production of dairy farmers. As prices rise, so should the value of those bonds, and the portfolio manager would expect to outperform the market.

On the other hand, the portfolio manager of an equity index fund might seek to replicate the performance of the S&P 500 index, which includes large firms operating in sectors across the economy. To do this, she would generally purchase all the equities in the S&P 500 index, or a representative sample of them. The value of the portfolio would rise and fall with the index.

Mutual funds also can be categorized by the types of assets they invest in. Some mutual funds invest only in US companies. Other mutual funds invest in foreign companies. Some invest only in the stocks of large, midsize, or small companies. Some invest in different types of bonds, and some even take a “balanced” approach, investing in both stocks and bonds. There’s an approach for just about every type of investor.

Approximately 55 million households in the US held mutual funds in 2016. Almost 81 percent of these households held mutual funds in a 401(k) plan or an IRA. In addition, many households hold mutual funds outside of retirement accounts, obtaining them from a variety of sources, including investment professionals, such as a full-service broker or an independent investment adviser; online platforms, such as fund supermarkets; or directly from the funds themselves.

Of course, regardless of how you invest in mutual funds, professional money management services are not free. Mutual fund investors pay for these services using fees, which—due to competition and rising assets in the industry—have been falling for decades. The fees charged by each fund are disclosed in a document called a prospectus, which we encourage you to read. If you have any questions, please contact a fund representative or an investment adviser.

I hope you found this brief overview of mutual funds helpful. For more information and resources, please visit www.ici.org.

Additional Resources

- *Investment Company Fact Book: How US-Registered Investment Companies Operate and the Core Principles Underlying Their Regulation*
- *ICI Research Perspective: “What US Households Consider When They Select Mutual Funds”* (pdf)
- *Frequently Asked Questions About Mutual Fund Shareholders*