

MUTUAL ATTRACTIONS

As interest in mutual funds grows, decisions can become more complicated



Staff Photo by Mike Zerby

Don and Jann Shaffer will be empty nesters in a few years. Their daughter Kristin starts college this fall and their son Eric will be a junior at Burnsville High School. With a household income of about \$70,000 a year, they are like many families who don't have much extra money to invest. Financial planner Robert Klosterman recommended a mutual fund portfolio for them but it does not allow for broad diversification, which would reduce their risk, because their investment amount is only \$200 a month. Details of their situation and other readers' stories on Pages 2D and 3D.

By Dan Wascoe Jr./Staff Writer

Lori Ecklund, a Farmington veterinarian, and her five brothers and sisters have pooled a \$100,000 inheritance from their parents and may move some of it from conservative utility bonds into mutual funds.

Jason and Jan Rice, Edina, are retired and looking for higher income than that produced by declining interest rates on certificates of deposit, savings accounts and annuities. They're looking into mutual funds, too.

For many Minnesotans — from students paying off loans to widows trying to preserve their nest eggs — the feeling is mutual.

Mutual funds offer potential earnings and spread risk by investing in a variety of stocks, bonds and other securities. Professional fund managers handle day-to-day transactions within defined strategies — growth of investment, production of current income, protection of principal or a combination.

The challenge for many investors is to find funds that match their own goals and risk tolerance.

John Collins, a spokesman for the Investment Company Institute in Washington, D.C., says that in these days of low interest rates, some people move resources into mutual funds

for the wrong reasons.

"I hope they're just not chasing yield. You can't lock in yield" with mutual funds, he said. Some people who move money from insured savings accounts or certificates of deposit "have never experienced market fluctuations," he said. They may grow alarmed watching the value of their mutual fund assets plummet if the markets fall.

Such people may be better off "taking their licks now" in low-interest savings accounts or certificates of deposit, knowing at least that their principal is insured, he said.

Nevertheless, about 36 million Americans in 27 percent of U.S. households have invested some money in mutual funds. Just since 1984, the number of funds has more than tripled and total assets have nearly quadrupled to nearly \$1.5 trillion.

But how to choose? There were 3,570 mutual funds at last count, some trying to set themselves apart with names such as the Pasadena Nifty Fifty and Scottish Widows International. And they vary widely in size, from small start-ups to the giant Fidelity Magellan Fund's \$20 billion in assets.

About 35 percent of all mutual funds invest in stocks, among the more volatile securities. About 41 percent specialize in bonds, whose fixed-income

features appeal to many investors. The remaining 24 percent include money-market and other funds that invest in short-term securities.

Fees vary, too. About 47 percent of all funds carry a load or sales charge, and all have one or more management fees. These days initial charges, called front-end loads, range from 4 to 6 percent of your investment, said Collins. But other fee options have multiplied since the mid-'80s.

As national boundaries and political systems change, mutual funds have tried to take advantage of profit-making opportunities around the world. In 1984, there were nine international funds; today there are 135.

Because of such growth, the rules keep changing. The Securities and Exchange Commission is considering capping some mutual fund fees, for example. It also is studying whether to permit foreigners to invest more easily, without tax penalties, in U.S. funds.

The thirst for advice about mutual fund investing is so strong that more than 220 Minnesotans responded to the Star Tribune's recent invitation to meet free with a financial planner to help choose a fund. Some of their stories are featured in today's On the Money.

Tips for choosing a mutual fund:

■ Weigh risks and expectations. Some mutual funds are more exposed than others to sharp swings in value. Try to determine if you will need to cash in your shares at a certain time — when a fund's value just might hit a low point, for example — or whether you can wait for values to turn up. Decide how much growth or income you expect within a defined time period. Compare those goals to your fund's performance.

■ Ask about total expenses. Many investors favor no-load funds, which require no up-front fees. But transaction fees, management fees and other expenses can eat into earnings, too.

■ Assess management style. The manager of a mutual fund might pursue a strategy emphasizing growth, while you might prefer income. Find out about that style before you invest.

■ Review more than one year's growth. This year's hot fund might be a flash in the pan. And a fund that focuses on one kind of stock — say biotech companies — can fluctuate more sharply than a broadly diversified fund. Review a fund's short-term and long-term performance.

■ Keep up to date. Although mutual funds hire professional managers to buy and sell stocks and bonds on a daily basis, investors need to consider changes in their own goals, the economy and evaluate the funds accordingly.

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They've put off planning for future

Don Shaffer bought a pickup truck late in July, just a few weeks before he and his wife Jann sat down with financial planner Robert Klosterman. If that conversation had come first, however, Don might have chosen to stick with his paid-up minivan and to put money into retirement savings instead of repaying a new 8.9-percent loan on the truck.

"Both of us have known all along that we haven't done real well with financial planning for the future," Jann said. "We have two children, a home, car payments. It's a day-in, day-out job to keep your nose above the water line."

But the Shaffers, 48, are approaching their empty-nest years. Daughter Kristin starts college this fall and son Eric will be a junior at Burnsville High School. Their household income of \$70,000 comes mostly from Don's job as an accountant for Apothecary Products and his weekend newspaper delivery job and Jann's work as a teacher's aide and a Wal-Mart employee.

While they have about \$24,500 in Individual Retirement Accounts and about \$6,400 in other cash and mutual fund assets, they met with Klosterman because they wanted to become more active in planning their retirement.

As a result of their meeting, Jann said they intend to invest the \$1,000 cash value of an insurance policy in an international mutual fund. She also plans to increase her \$25-per-check purchase of Wal-Mart stock, which the retailer matches 15 percent. And she may take advantage of a tax-deferred annuity offered through the school district — a valuable option because it permits investing pre-tax dollars.

Klosterman, who heads the Twin Cities Institute of Certified Financial Planners, said the Shaffers' circumstances are typical of many Americans who don't have much extra income to invest. The amount they decided to start with — about \$200 a month — is not great enough to permit broad diversification, which would reduce risk. But more diversification will become possible as their savings build. They hope to increase their investment commitment by about 10 percent each year.

Klosterman said he recommended an eventual portfolio of 33 percent international stock funds, 21 percent international bond funds, 15

percent real estate trusts, 11 percent aggressive growth funds, 10 percent less risky growth funds and 10 percent in government bonds.

Jann said the family's first priority is paying their daughter's college expenses; their son is not likely to attend college. Any retirement investments should offer "a fairly decent return with as little risk as possible," she said.

About \$100 of their available \$200 may go into the annuity. As for the rest, Klosterman helped the Shaffers through a computerized screening process to identify potential mutual funds.

He and the Shaffers agreed to consider funds that earned at least three stars from Morningstar, Inc., a Chicago-based rating company whose highest rating is five stars. They wanted funds and fund managers with track records of at least five years.

This process whittled 66 global funds down to seven, and Klosterman said, "There are not many dogs in this group."

Next he applied another screen: "alpha" and "beta" statistical measurements that compare a fund's performance with the overall market and try to assess relative risk.

This filter reduced the field to two global stock funds: SoGen International, which carries a 3.75 percent sales charge (called a load) and American Funds' New Perspective, whose load is 5.75 percent. Both are five-star funds under Morningstar's system, and both focus on long-term growth of capital by investing in both U.S. and overseas companies and other securities.

Morningstar shows SoGen with a 10-year annual total return of 17.98 percent and describes its risk as low. New Perspective's 10-year return is 18.1 percent and its risk is considered below average. Besides these factors, Klosterman recommended SoGen because of its recent performance and broad diversification.

Jann said that she and Don thought Klosterman's approach was "well thought out" and that they were "fascinated by the process" of using a computer to help winnow the choices. In the end, she said, "We felt less intimidated and more prone to get cracking."