3 Principles For Wise Investing In Mutual Funds

It is a fact that a safer way to invest in a wide range of equities is to invest in them through a mutual fund holding. Achieving proper diversification is often difficult for investors purchasing individual securities. For example, many professionals recommend investing in a minimum of 15 stocks in order to have a properly diversified equity portfolio.

This can require a capital investment which simply isn't feasible for many people. Moreover, researching and monitoring a large stock portfolio can be a cumbersome chore.

That is why so many investors turn to mutual funds, which are an affordable and convenient way to diversify your portfolio. Mutual funds are designed to meet specifically stated investment goals. With such diversification, an individual may own many more issues in their particular asset class.

Many funds target a specific industry sector, investing in many stocks across that sector. For instance, there are mutual funds which invest in stocks of small, emerging companies and other funds which emphasize investments in securities of international companies.

Shareholders who invest a few hundred dollars in a mutual fund receive the same investment return, the same professional management, and the same diversification as those who invest much more.

Professional managers of the fund are able to invest the fund's assets in a variety of securities, targeting hot industries and selecting the best individual stocks within those industries. This approach to investing allows the individual to reduce risk while participating in the opportunities offered.

The Principle of Seeking Out Low Cost Funds

In the 90's, gains-hungry investors paid no more attention to fund expenses than drag racers do to gas mileage. Who cared about costs as long as stock funds were piling up average annual gains of over 15 percent and bond funds were churning out 10 percent or more a year?

In the present decade, when analysts expect yearly returns to be three to five points lower, fees and expenses will be larger, increasing losses and slowing subsequent recoveries. For instance, according to Money Magazine, a no-load fund with a 9.75 percent gross return and a low 0.75 percent annual expense ratio would build $10,000 into $23,670 over the next 10 years. A 4 percent load fund with a stiff 1.5 percent charge would knock that down to $21,210.

As a rule, avoid domestic stock funds with annual expenses that total more than 1.5 percent of assets.

In evaluating international funds, in which the cost of doing business overseas increases fees, cut out any fund charging more than 2 percent a year. With bond funds, insist on expenses below 1 percent.

The Principle of Dollar-Cost Averaging

Investing a fixed amount of money at regular intervals—say, $100 to $500 a month—takes much of the risk out of stock funds, with little effort. For one thing, it prevents you from committing your total dollars available at a market peak. And if your fund's share value does drop, your next installment payment automatically picks up more of the lower-priced shares. That cuts your average cost per share and boosts your eventual gain.

The Principle of Building a Well-Balanced and Diversified Portfolio

Most investors are familiar with the don't-put-all-your-eggs-in-one-basket logic of diversification. Fewer really understand how powerful a risk-reducing tactic it is. Sensible diversification costs you relatively little in performance.

Analysts say that you should divide your money among funds with different styles. Over any investment period of 10 years or more, funds with differing investment philosophies will take turns outperforming—and being outperformed by those with other philosophies. Some experts suggest that you put 40 percent of your stockholdings into value funds.

Value investing typically pays off best at the end of a bear market and in the early part of a new bull market. By diversifying among funds, you acknowledge the unpredictability of markets and lessen the damage if you're wrong. In an uncertain market, diversification is king. Whatever happens, if your money is spread among assets and investment styles, you should be able to sleep at night.