

# Your Money and You

*A college student's guide to money management*

## From the desk of the Money Page Editor

Are you a motivated writer? Do you take keen interest in Finance, Economics, or anything with business related affairs? Would you like to see your name and your articles in the future issues of the *Behrend Beacon*?

If you answer is yes to any of the questions above, we are looking for keen, energetic people like you to join the the Money Page team.

Please email the Money Page Editor at [axs428@psu.edu](mailto:axs428@psu.edu) for further consideration. Remuneration will be in the form of up to two course credits.

Thank you for reading the Money Page and have a very fruitful semester.

**Amortya Sinha**  
Money Page Editor  
2000 - 2001

# Mutual Funds and you

Mutual funds are financial intermediaries. They are companies set up to receive your money and then make investments with the money. When you buy mutual fund shares, you are a shareholder of that mutual fund, with voting rights in proportion to your ownership of the fund. Every mutual fund issues a prospectus, which describes the fund's investment policies and objectives, risks, costs and historical performance data. The prospectus also describes the investment style of the fund. Nowadays, you can also find the essential information about mutual funds on various Internet sites.

### Advantages of Mutual Funds:

**Diversification:** A mutual fund provides instant holdings in several different companies, giving a level of stability to your investment.

**Liquidity:** A mutual fund investment can be converted into cash upon your request.

### Disadvantages of mutual funds:

**No control or limited control:** Unlike picking your own individual stocks, buying a mutual fund puts you in the passenger seat instead of the driver's seat.

### Types of Mutual Fund:

#### Bond Funds

Bond mutual funds are pooled amounts of money invested in bonds. Bonds are debt notes issued by companies or governments. A purchaser of a bond is lending money to the issuer, and will usually collect some regular interest payments until the money is returned. Usually, the amount of interest paid (the coupon) is fixed at a set percentage of the amount invested. Thus bonds are called "fixed-income" investments.

#### General Equity (Stock) Funds

Stocks represent part ownership or equity, in corporations. The goal of stock ownership is to see the value of the companies increase over time. Stocks are often categorized by their capitalization and like many other things come in three basic sizes: small, medium, and large. Many mutual funds invest primarily in one of these sizes and are thus classified as "large-cap", "mid-cap", or "small-cap funds". Additionally, mutual funds are often categorized by the type of stock that is bought. Mutual fund types are generally "growth," "value," or a combination of the two, called "blend."

#### Balanced Funds

Balanced funds mix some stocks

and some bonds. A typical balanced fund might contain about 50-65% stocks and hold the rest of the shareholder's money in bonds and cash. It is important to know the distribution of stocks to bonds in a specific balanced fund to understand the risks and rewards present in that fund.

### Global and International Funds

Global and international funds invest in companies who are based in other parts of the world. In general, international funds are more volatile than domestic funds. International funds generally invest only in foreign companies, while global funds may invest in some U.S. based companies in addition to foreign companies.

### Sector Funds

Sector funds invest in one particular sector of the economy: technology, banking, computers, the Internet, etc. Sector funds can be extremely volatile because the market will find certain sectors very attractive and some very unattractive often in rapid succession.

### Index Funds

The index mutual fund owns a full participation in a portion of the stock market. An index fund matches the shareholdings of a target index, such as the Standard & Poor's 500 Composite Stock Price Index (S&P 500). Index funds are distinct from actively managed mutual funds in that they do not involve any stock picking but that they simply seek to replicate the returns of the specific index.

### Can you beat the market with Mutual Funds?

Yes. Every year there are some mutual funds that beat the overall market and there are even years when the majority of mutual funds beat the market. But trying to pick a mutual fund ahead of time that will beat the market is extraordinarily difficult. So trying using this list when picking your mutual funds:

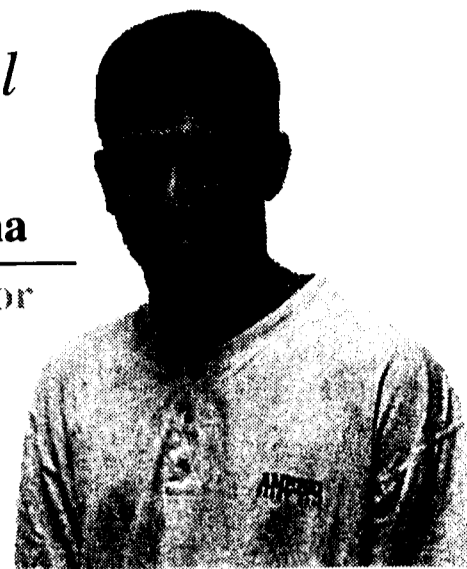
- 1) No sales charges.
  - 2) A low expense ratio (below 1%)
  - 3) Low turnover, no higher than 50% a year, preferably closer to 20%
  - 4) Full investment policy i.e. cash reserves of nearly 0%.
- Studies show that over time, all of the difference in return between managed funds and index funds is attributable to the higher costs imposed by actively managed funds. These costs come in the form of loads and expense ratios.

**Sales Charge:** You want to make sure that you are not paying any

## Financial Outlook

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sales charges. Sales charges come in various forms, also known as loads or commissions. There might be a charge for buying into the fund (a front-end load) or selling the fund (back-end load, deferred sales charge, or redemption fee). Avoid all of these. Some funds have back-end loads that are reduced the longer you hold the fund. Best to avoid these as well. If you have to buy an actively managed fund, buy the fund with no sales charges at all.

**Expense ratios:** These represent the annual fees charged by all funds, including the management fee, the administrative costs, distribution fees and other expenses. You want to make sure that the fees are as low as possible. Index funds typically charge about 0.20% of the assets, and actively managed funds currently average about 1.5% per year. The average fee has been climbing in recent years. Any fund that has fees above 1% per year can be expected to underperform the total returns offered by an index fund.

**Turnover:** This measures how long a fund holds on to the stocks it buys. The longer a mutual fund holds on to a stock and the less trading the fund does, the lower the turnover will be. Since a fund incurs costs every time it buys and sells stocks, the lower the turnover, the lower the transaction costs incurred by the fund. Funds that have a turnover of 100% are essentially buying a completely new set of companies every year. Turnover should ideally be substantially lower than the mutual fund average of about 80%. Index funds have a turnover rate as low as 5%.

Make sure to check out the consistency of the fund's returns. You're looking for funds that not only have shown good returns on the whole, but ones that do so on a consistent basis, rather than having great runs followed by lousy ones. Most funds that claim to have outperformed the market over a ten-year period really had most or all of their truly good performance when they were young and small. Once the fund has attracted a couple

of billion extra dollars, the fund usually starts performing more in line with the market.

### Studying the Prospectus of the fund:

Mutual funds have two goals: to make themselves money and to make you money. Hence with these two goals of mutual funds in mind look for the following answers when reading a mutual fund's prospectus:

- 1) How much is the fund going to make from managing your money?
- 2) What kinds of returns has the fund delivered for investors in the past, and what does it generally invest in to achieve these results?

### Wrapping things up:

Mutual funds are very strong and sometimes very fruitful tools of investing your hard earned dollars while in college and later on at the professional workplace. If invested carefully, you might end up taking trips to the Bahamas every summer or looking at the other end of the street, have to get a second full time job to cover up for the lost money when invested badly.

On the contrary to the belief that you need at least \$ 5000 to start investing in a mutual fund, several mutual fund management companies such as T. Rowe Price and Janus, among the big names have mutual funds that can be invested in by just putting \$ 50 a month.

Mutual funds are usually safer and less volatile than investing in the stock market and provide novices with a feel for investing. You may not make your first million upon graduation investing in mutual funds, but you may discover Warren Buffett in you.

# GOP Leaders want even more tax cuts than Bush

by Jill Zuckman  
Chicago Tribune

Republican congressional leaders plan to tack their own treasured tax cuts onto President Bush's tax bill, potentially enlarging the cost beyond its \$1.6 trillion price tag.

House Majority Leader Dick Arme, R-Texas, said Tuesday that he would like to "go beyond (Bush's) plan" with an expansion of individual retirement accounts, a reduction in the capital gains tax rate and an end to the alternative minimum tax, designed to prevent the wealthy from taking so many deductions that they owe no taxes at all.

"It is my recommendation that we reconsider the extent to which we might want to, in fact, have even more tax reduction than what is currently planned," said Arme, who noted that he favors Bush's ideas to reduce across-the-board income tax rates, eliminate the so-called marriage penalty and kill the estate tax.

In the Senate, Majority Leader Trent Lott of Mississippi said the surplus is "more than enough" to cover "at least" \$1.6 trillion in tax cuts. He also said he would like to expand the amount people can contribute to their 401(k) accounts and to reduce taxes on gains earned from investments.

The leaders' words indicate Bush's tax plan may be in for a rough ride as Democrats try to scale back the package, businesses clamor for additional tax breaks and Republicans mold the legislation to better reflect their own ideals. Tax bills are notorious magnets for special-interest breaks helping entire business sectors—even specific corporations.

As Bush plans to send his tax plan to Congress on Thursday, Republicans believe they have significant room to tack on proposals. They control both chambers of Congress, and Bush is likely to be loath to veto any tax-cut package after making it a keystone of his campaign and first weeks in office. "What you'll probably see is a bidding war going on," said Chuck Pizer, the legislative director to the House Ways and Means Committee when Dan Rostenkowski was chairman. "The more arcane the provision, the more support it will have from some of the business lobbyists."

Despite Republicans' desire to address a plethora of tax issues, Lott said he is worried about the consequences. There is a danger that it could get out of hand, and I think we should be careful how we make changes of what (the president) is proposing," he said.

Last weekend, during a Republican retreat in Williamsburg, Va.,

Lott, warned his colleagues against loving the tax bill "to death." He added: "The greatest danger there, is that we get carried away, and start adding too many things to it and wind up pulling it down."

On Tuesday, just across the Potomac River from Washington at Tree Top Toys and Books in McLean, Va., Bush told small-business owners that lower taxes would result in more customers and more money. His plan, designed to reduce taxes by \$1.6 trillion over the next decade, would consolidate the five tax brackets into four and lower the highest rate from nearly 40 percent to 33 percent.

"There's more of your own money in your pocket to be able to make sure that your small business flourishes," Bush said. "Many Americans have got a consumer debt load that is significant. This tax relief package is not only good for taxpayers, it is also good to stimulate and help the entrepreneurial spirit in America."

Though Lott, Arme and other conservative Republicans would like to reshape Bush's tax package, other Republicans are eager to stick to the president's plan and move it quickly, saving the rest for another day.

"We could do another tax bill next year," Sen. Phil Gramm, R-Texas, said. "This doesn't have to

be the be-all and end-all of tax bills."

Sen. Peter Fitzgerald, R-Ill., said attempts by special interests to load the bill with tax breaks would make Bush's task more difficult.

"He'll have to really work the phones and use his honeymoon to tell legislators to back off," Fitzgerald said of Bush. "It's going to be a political free-for-all." Sen. Olympia Snowe, R-Maine, said she cannot imagine voting for a tax cut larger than \$1.6 trillion. She recalled that when President Ronald Reagan sent a tax bill to Capitol Hill in 1981, a bidding war between Democrats and Republicans resulted in billions of dollars in extra spending and leading to annual budget deficits.

"It really did open the floodgates," Snowe said. "We better make sure that doesn't happen." Democrats, on the other hand, say they already believe the \$1.6 trillion cut is too large and would disproportionately benefit the rich. Sen. Patty Murray, D-Wash., said she is worried that the combination of an energy crisis and lost jobs could affect projections of huge government surpluses.

"I don't want to be left with nothing," she said. "I hope everybody is sufficiently concerned about economic forecasts that have gone awry before so that we can be disciplined."

Besides Arme and Lott, House Speaker Dennis Hastert, R-Ill., would also like to cut capital gains taxes as part of the tax-cut legislation. His spokesman, John Feehery, said Hastert called Bush's \$1.6 trillion cut "the cost right now," leaving himself open to a possible change.

Even Bush's allies are asking for more. At the U.S. Chamber of Commerce, President Thomas Donohue said he enthusiastically supports the Bush plan, calling it a benefit to small businesses. But he also said he would like to end the alternative minimum tax and adjust the capital gains depreciation.

Similarly, the National Association of Manufacturers supports the Bush proposals. But they are also asking for a repeal of the alternative minimum tax and a permanent extension of the research and development tax credit.

Following his weekly luncheon with Republican senators Tuesday, Vice President Dick Cheney told reporters that he and Bush recognize Congress intends to work its will during the legislative process.

"We look forward to working with the Congress to perfect the bill during the legislative process," Cheney said. "But I would not expect any significant change in the basic content of the legislation that we plan to send up."

## Heard on the Street:

The exchange rate for some selected currencies to one U.S. dollar:

Euro: 1.07  
Deutsche Mark: 2.10  
Japanese Yen: 116.27  
British Pound: 0.68  
French Franc: 7.06

From Wall St. we have the closing market figures for 02/07/2001:

DJIA:  
10946.72  
down 10.70 (-0.10%)

NASDAQ:  
2607.82  
down 56.67 (-2.13%)

S&P 500:  
1340.89  
down 11.37 (-0.84%)

BOND:  
110 9/32  
down 1/2  
(current rate is 5.53%)