

Basics of Mutual Fund Investing and the Usage of Benchmarks

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"I think I speak for all of us when I say what in God's name are you talking about?"

Agenda

- What are mutual funds?
- How do mutual funds work?
- What are investment benchmarks?
- Why are benchmarks important?
- How are benchmarks calculated?



Mutual Funds - Defined

Mutual Funds - a type of professionally-managed collective investment vehicle that pools money from many investors.



Mutual Funds – Interesting Facts

- ❖ Oldest mutual fund is the MFS Massachusetts Investors Funds established in 1924.
- ❖ Currently there are 7,693 mutual funds in the U.S. In 1980, there were 564 mutual funds in the U.S.
- ❖ Those 7,693 mutual funds have \$12.4 Trillion in assets.
- ❖ Half of all 401k assets and IRA assets in the U.S. are invested in mutual funds.

Mutual Funds - Advantages

- ❖ Increased diversification
- ❖ Daily liquidity
- ❖ Professional investment management
- ❖ Ability to participate in investments that may be available only to larger investors
- ❖ Ability to acquire investments (international stocks) that cannot be purchased directly (individual bonds and stocks)

Mutual Funds - Advantages

- ❖ Service and convenience
- ❖ Government oversight
- ❖ Service and convenience
- ❖ Ease of comparison



Mutual Funds - Disadvantages

- ❖ Fees
- ❖ Penalties
- ❖ Lockouts
- ❖ Less control over timing of recognition of gains
- ❖ Less predictable income
- ❖ No opportunity to customize

Mutual Funds - Types

❖ Stock

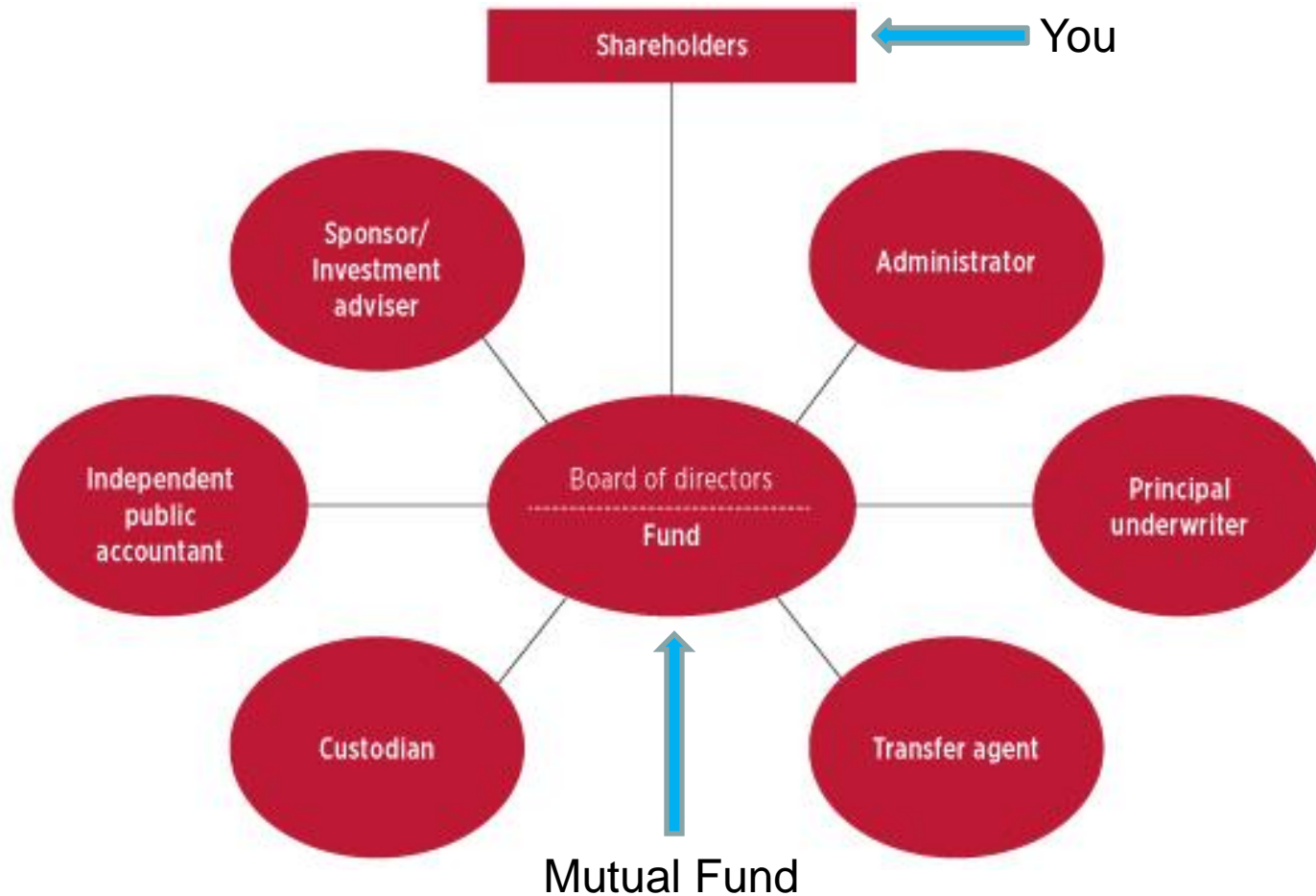
- Market Cap (Large, Mid, Small)
- Style (Growth, Value, Core)
- Domestic and International
- Actively Managed and Indexed
- Specialized (REIT, Socially Conscious)



❖ Fixed Income

- Taxability - Taxable and Tax-Free
- Type (Government, Corporate, Municipal, High Yield)
- Duration (Short-Term, Intermediate-Term, Long-Term)

Mutual Funds - Structure



Mutual Funds - Structure

❖ Shareholders

- Voting rights
 - Elect Directors
 - Material Changes to Contract with Investment Advisor (fee increases)

❖ Sponsor

- Completes process to start mutual fund (organizes fund under applicable state law, registers with the SEC, registers the fund shares for sale to the public)
- Usually the funds' investment advisor
- Assembles third parties to launch fund
- Provides officers to oversee the fund
- Recruits unaffiliated persons to serve as independent directors

Mutual Funds - Structure

❖ Advisers

- Responsible for directing the fund's investments and handling its business affairs

❖ Administrators

- Handles “back office” functions
 - Clerical and fund accounting services
 - Data Processing
 - Internal Auditing
 - SEC, Tax and Shareholder reporting duties

Mutual Funds - Structure

- ❖ Principal Underwriter (fund distributor)
 - Investors buy and redeem fund shares through principal underwriter
 - SEC Registered Broker Dealer
- ❖ Transfer Agent
 - Maintains records of shareholder accounts
 - Calculate and distribute dividends and capital gains
 - Mail shareholder account statements
 - Distribute shareholder tax information
- ❖ Auditor
 - Audits and certifies the financial statements of the fund

Mutual Funds - Governance

- ❖ Four Principal Securities Laws Govern Investment Companies
 - The Securities Act of 1933
 - The Securities Exchange Act of 1934
 - The Investment Advisers Act of 1940
 - The Investment Company Act of 1940



Mutual Funds - Regulation

Mutual funds incorporate several core principles that provide protection for investors.

- ❖ Transparency
- ❖ Daily Valuation and Liquidity
- ❖ Oversight and Accountability

Mutual Funds - Regulation

Transparency

- ❖ Mutual funds are subject to more extensive disclosure requirements than other comparable financial products.
- ❖ Mutual Funds are required to maintain a current prospectus.

Mutual Funds - Regulation

Daily Valuation and Liquidity

- ❖ Mutual funds offer shareholders liquidity and objective, market-based valuation of their investments at least daily.
- ❖ Mutual fund shares are redeemable on a daily basis at a net asset value (NAV) that reflects the closing value of the basket of securities.

Mutual Funds - Pricing

Fund X owns a portfolio of stocks worth \$6 million;
its liabilities are \$60,000; its shareholders own 500,000 shares.

$$\begin{array}{r} \text{Net asset value (NAV)} \\ \text{\$11.88} \end{array} = \frac{\begin{array}{r} \text{Market value in dollars of securities} \\ \text{minus liabilities} \\ \text{\$6,000,000 - \$60,000} \end{array}}{\begin{array}{r} \text{Number of investor shares outstanding} \\ \text{500,000} \end{array}}$$

*NAVs can be found on most major financial websites or
in the financial pages of most major newspapers.*



Mutual Funds - Regulation

Oversight and Accountability

- ❖ Mutual Funds Oversight
 - Board of Directors
 - Chief Compliance Officers
 - SEC
 - Financial Industry Regulatory Association (FINRA)
 - Certified Public Accountants
 - Custody of Assets

- **How do you select the best mutual funds?**
 - Morningstar
 - Bloomberg
 - Various publications
 - Consulting services
 - Brokerage firms
- **Types of information needed to identify quality mutual funds.**

Data through April 30, 2012. For internal and/or client reporting purposes only.

Royce Pennsylvania Mutual Invmt

Morningstar Analyst Rating 11-21-11

Silver

Morningstar Pillars

- Process Positive
- Performance Positive
- People Positive
- Parent Positive
- Price Positive

Morningstar Analyst Rating

Morningstar evaluates mutual funds based on five key pillars, which its analysts believe lead to funds that are more likely to outperform over the long term on a risk-adjusted basis.

Analyst Rating Spectrum

- Gold
- Silver
- Bronze
- Neutral
- Negative

Risk Spectrum

- Positive
- Negative
- Neutral

Performance 04-30-12

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total
2008	-6.28	1.48	-7.19	-8.11	-34.78
2009	-11.94	22.91	20.91	4.16	36.28
2010	6.56	-8.54	10.53	14.98	23.86
2011	9.10	-1.81	-21.07	13.34	-4.17
2012	12.08				

	Total	+/-	+/- Beta	%Rank	Growth of \$10,000
3 Mo	2.78	-9.81	-9.66	76	10,278
6 Mo	8.33	-17.56	-21.50	85	10,833
1 Yr	-5.50	-14.04	-5.32	78	9,450
3 Yr Avg	19.66	-3.76	-7.24	62	17,134
5 Yr Avg	2.28	0.27	0.35	34	11,193
10 Yr Avg	7.87	3.75	1.42	17	21,331
15 Yr Avg	10.85	4.55	3.19	11	45,832

Tax Analysis Tax-Adj Retn % %Rank Cat Tax-Cost Rat %Rank Cat

3 Yr (estimated)	18.35	56	0.26	64
5 Yr (estimated)	1.68	28	0.58	47
10 Yr (estimated)	7.12	16	0.70	33

Potential Capital Gain Exposure: 23% of assets

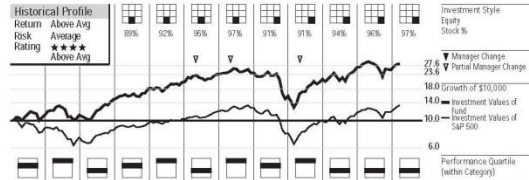
Morningstar's Take by Karin Anderson 11-21-11

Royce Pennsylvania Mutual remains nimble and successful despite its huge asset base. At \$5.8 billion in assets, Royce's flagship offering is larger than all but two other small blend funds. Small- and micro-cap stocks can be thinly traded, but lead manager Chuck Royce's deep-seated belief in stock diversification has kept the fund nimble. With nearly 500 names, the fund owns three times as many stocks as its typical peer.

Royce's valuation discipline further differentiates the fund. He and co-manager Jay Kaplan, who runs a small sleeve here, favor financially sound firms trading 30% to 50% below their estimated value. The duo patiently builds and trims hundreds of positions, limiting the market impact that comes with moving large sums in and out of small cap stocks.

Other distinguishing characteristics of the fund include a 18% allocation to micro-cap names. As of Sept. 30, that figure tripled the category norm. With 10% of assets invested abroad, moreover, the fund's foreign stock exposure surpasses 30% of its peers'.

Address: Royce Fund
New York, NY 10151
800-221-4268
www.roycefunds.com
Inception: 12-12-62
Advisor: Royce & Associates, LLC
Subadvisor:
NIP Plan: Etards No Load Lit



Year	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	04-12	History
Return	7.39	6.59	8.88	10.14	10.78	11.57	10.82	6.94	9.45	11.65	10.76	11.84	NAV
Above Avg	18.38	-9.22	40.29	20.23	12.50	14.78	2.75	-34.78	36.28	23.86	-4.17	10.04	Total Return %
Risk Rating	30.27	12.88	11.61	9.35	7.59	-1.01	-2.14	2.22	9.82	8.80	-6.28	-2.55	+/- S&P 500
Analyst Rating	15.89	11.26	-6.96	1.90	7.95	3.59	4.32	-0.99	9.11	2.89	0.01	2.40	+/- Beta 2000
Income Return %	0.33	0.00	0.00	0.00	0.00	0.35	0.70	0.08	0.11	0.57	0.17	0.00	Income Return %
Capital Return %	18.05	-9.22	40.29	20.23	12.50	14.43	2.05	-34.96	36.17	23.29	-4.34	10.04	Capital Return %
Total Return % Rank Cat	38	14	57	89	12	52	22	81	29	83	57	65	Total Return % Rank Cat
Income	0.02	0.00	0.00	0.00	0.04	0.08	0.01	0.01	0.05	0.02	0.00	0.00	Income
Capital Gains \$	0.70	0.12	0.36	0.53	0.63	0.77	1.01	0.10	0.00	0.00	0.38	0.00	Capital Gains \$
Expense Ratio %	0.99	0.94	0.93	0.89	0.90	0.87	0.88	0.89	0.92	0.90	0.90		Expense Ratio %
Income Ratio %	0.24	-0.13	-0.17	-0.20	0.49	0.39	0.44	0.55	0.33	0.63	0.11		Income Ratio %
Turnover Rate %	39	33	30	32	26	38	43	36	23	25	20		Turnover Rate %
Net Assets \$ml	445.1	462.1	639.1	1,242.1	1,850.1	2,866.1	3,158.1	2,303.1	3,556.1	4,736.1	4,317.1	4,645.1	Net Assets \$ml

Rating and Risk

Time Period	Lead-Adj Return %	Morningstar Rank vs Cat	Morningstar Risk-Adj Rating
1 Yr	5.50	Avg	***
3 Yr	19.66	Avg	***
5 Yr	2.28	-Avg	****
10 Yr	7.87	-Avg	*****
Incept	8.08		

Other Measures	Standard Index	Bid/Fl Index	Mutual Small Cap
Alpha	S&P 500		0.0
Beta	-2.9		0.0
R-Squared	1.20		0.91
Standard Deviation	68		89
Mean	19.66		
Slope Ratio	1.00		

Portfolio Analysis 03-31-12

Share change since 12-31 Total Stocks 517

Sector	PE	Tot Retn %	% Assets
◆ Kennametal Inc.	11.7	16.02	1.01
◆ Adco Board Company	68.0	19.42	0.95
◆ Western Copper	11.1	12.67	0.82
◆ Heilmann & Payne, Inc.	12.4	-7.44	0.77
◆ Ascena Retail Group, Inc.	18.3	49.13	0.76
◆ Technology	16.1	11.59	0.71
◆ Federated Investors, Inc.	13.9	47.33	0.70
◆ Ichor Laboratories	31.4	13.63	0.69
◆ Dial Corporation	10.5	-7.84	0.67
◆ Lincoln Electric Holding	19.2	25.72	0.66
◆ Reliance Steel and Alum	12.3	16.31	0.66
◆ Valmont Industries, Inc.	14.4	36.70	0.65
◆ Etham Allen Intermittent	28.7	7.09	0.65
◆ Applied Industrial Techn	12.3	17.94	0.64
◆ SEI Investments Company	18.7	19.25	0.64
◆ Ichor Corporation	29.3	-11.68	0.64
◆ Morningstar Inc	32.8	6.22	0.64
◆ Ritchie Bros. Auctioneer	33.0	8.12	0.63
◆ National Instruments Cor	34.8	5.36	0.63
◆ Ansys, Inc.	34.0	13.51	0.62

Current Investment Style

Market Cap	%	Sector	% of Assets	High/Low
Giant	0.0	◆ Cyclicl	18.42	0.78
Large	0.3	◆ BasicInd	3.88	0.91
Mid	41.1	◆ CommCty	11.46	1.26
Small	39.3	◆ FinanSvs	1.17	0.37
Micro	19.3	◆ Real Est	1.91	0.28
Avg Smlk	1.718	◆ Sensitive	53.59	1.07

Value Measures

Ratio	Value	Peer Category	Value
P/E	15.40	◆ CommSert	22.29
P/B	1.84	◆ Energy	11.65
P/S	1.76	◆ Industri	2.10
P/Cash	1.36	◆ Technly	6.92
P/Cash Flow	7.63	◆ Defensiv	27.98
Dividend Yield %	1.63	◆ CommDef	6.75
		◆ Hlthcare	9.46
		◆ Utilites	11.77

Growth Measures

Ratio	Value	Peer Category	Value
Long Term Emrg	12.89	◆ Rel Categ	1.04
Book Value	7.17		4.32
Sales	7.93		6.45
Cash Flow	6.75		1.97
Historical Emrg	9.17		1.97

Profitability

Ratio	Value	Peer Category	Value
Return on Equity	16.40		1.30
Return on Assets	9.08		1.54
Net Margin	10.22		1.18

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Benchmarks (Indices) Explained



Index	Last	Change	% Chg
Industrials*	13265.47	-208.10	-1.56%
Nasdaq Composite*	2562.24	-37.10	-1.43%
S&P 500*	1458.95	-23.71	-1.60%
DJ Wilshire 5000*	14710.78	-227.49	-1.52%
Russell 2000*	777.83	13.65	1.72%

Benchmarks

Investment Benchmark (Indices) - A standard against which the performance of a security, mutual fund or investment manager can be measured. Generally, broad market and market-segment stock and bond indexes are used for this purpose.

Answers the Question – How well is my investment manager doing?

Benchmarks

- ❖ An appropriate benchmark (Index) should be reflective of the type and style of the investment manager being gauged. For example, a large cap U.S. equity manager should be gauged against a benchmark that contains large cap U.S. stocks. An international benchmark would be inappropriate.

Benchmarks

- ❖ Indices have evolved and are used for a variety of purposes:
 - as portfolios (index funds – passively managed),
 - as benchmarks for actively managed funds, and
 - as proxies for asset classes in asset allocation

Benchmarks

- ❖ Common Benchmarks (Indices):
 - Dow Jones Industrials (30 U.S. Large Cap Stocks)
 - Standard & Poor's 500 (500 Large Cap U.S. Stocks)
 - MSCI EAFE (International Stocks)
 - Russell 2000 (Small, Mid Cap Stocks)
 - Barclay's Aggregate Bond Index (combination of US Treasury, US government and corporate securities)
- ❖ There are thousands of different indices covering all types of investments.



Benchmarks

Characteristics of a valid benchmark:

- Unambiguous
- Investable
- Measurable
- Appropriate
- Reflective of current investment opinions
- Specified in advance

Benchmarks

- ❖ The first benchmark was Charles Henry Dow's pioneering average, which he began to calculate in 1884.
- ❖ The first Dow Jones average was simply the average of the prices of 11 railroad stocks.
- ❖ This number was published daily, providing investors with a constantly updated barometer of the market.

Benchmarks

- ❖ In 1923 the Standard Securities Corporation (now Standard & Poor's) constructed the first **market-capitalization weighted** index.
- ❖ This index, a composite of 223 securities, later evolved into the S&P 500 Index (500 securities). Such an index gives each company a weight in proportion to the total market value of that company's outstanding shares.
- ❖ Most of the market indexes in use today are market-capitalization weighted.

Benchmarks – S&P 500

Market Capitalization Example

Total Shares of IBM Outstanding = 1,188,700,000

Current Share Price of IBM = \$193.13

1,188,700,000 Shares X \$193.13 = \$229,573,631,000

IBM Market Cap = \$229,573,631,000

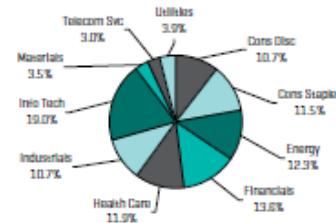


S&P 500 December 30, 2011

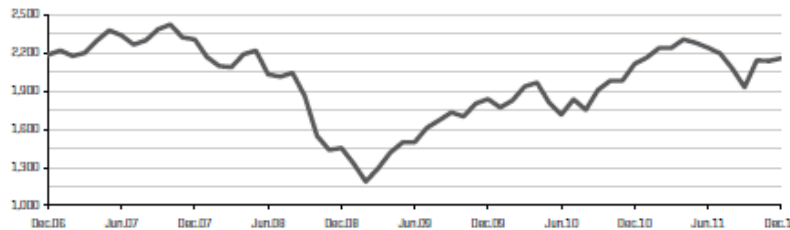
Index Performance

Returns	1 Month	1.02%
	3 Month	11.82%
	YTD	2.11%
Annualized Returns	1 Year	2.11%
	3 Years	14.11%
	5 Years	-0.25%
	7 Years	2.64%
Annualized Risk	3 Years Std Dev	18.57%
	5 Years Std Dev	18.88%
Sharpe Ratio	3 Years	0.2269
	5 Years	0.0040

Sector Breakdown



5 Year Historical Performance



Top 10 Companies By Weight

Company	Float Adj Market Cap (USD Million)	Index Weight	Sector Weight	TWF	GICS® Sector
Exxon Mobil Corp	406,272.3	3.57%	29.09%	1.00	Energy
Apple Inc.	376,410.6	3.31%	17.40%	1.00	Information Technology
Intl Business Machines Corp	216,724.3	1.90%	10.02%	1.00	Information Technology
Chevron Corp	211,893.9	1.86%	15.17%	1.00	Energy
Microsoft Corp	194,358.4	1.71%	8.98%	0.89	Information Technology
General Electric Co	189,082.2	1.66%	15.54%	1.00	Industrials
Procter & Gamble	183,540.6	1.61%	13.57%	1.00	Consumer Staples
AT&T Inc	179,202.2	1.57%	53.13%	1.00	Telecommunication Services
Johnson & Johnson	179,089.1	1.57%	13.27%	1.00	Health Care
Pfizer Inc	166,346.0	1.46%	12.33%	1.00	Health Care

Tickers

S&P 500	
Price Returns	
BLOOMBERG®	SPX
Reuters	SPX
Total Returns	
BLOOMBERG®	SPTR
Reuters	SPXTR

Index Portfolio Characteristics

Number of Companies	500
Adjusted Market Cap (USD Billion)	11,383.19
Company Size By Market Cap (Adjusted USD Billion):	
Average	22.77
Largest	406.27
Smallest	1.22
Median	10.75
% Weight Largest Company	3.57%
Top 10 Holdings (% Market Cap Share)	20.23%

Source: S&P Indices. Data as of December 30, 2011. Index levels are in total return US\$. Charts and graphs are provided for illustrative purposes. Past performance is not a guarantee of future results.

S&P 500 Characteristics

- ❖ Represents approximately 75% of the total U.S. market cap.
- ❖ Consists of 500 U.S. companies
- ❖ 10 Industry Sectors
 - Consumer Discretionary
 - Consumer Staples
 - Energy
 - Financials
 - Health Care
 - Industrials
 - Information Tech
 - Materials
 - Telecom
 - Utilities
- ❖ Largest Company – Apple 4.70% of the S&P 500

Benchmarks – S&P 500

- ❖ How is the S&P 500 constructed and calculated?
- ❖ For a company to be considered for inclusion in the S&P 500 it must meet the following criteria:
 - Market Capitalization - \$4 billion or greater
 - Liquidity – average daily trading volume of at least 250,000 shares
 - Domicile – U.S.
 - Public Float – at least 50% of their shares
 - Financial Viability – at least four consecutive quarters of profitability
 - Eligible Securities – Stocks traded on NYSE, AMEX or NASDAQ

Benchmarks – S&P 500

- ❖ The Standard & Poor's 500 Index is calculated using a base-weighted aggregate methodology; that means the level of the Index reflects the total market capitalization of all 500 component stocks relative to a particular base period.
- ❖ The S&P 500's base period is 1941-43. The actual total market value of the stocks in the Index during the base period has been set equal to an indexed value of 10.
- ❖ You add the market capitalizations from all 500 companies each day and divide them by the index divisor.
- ❖ The index divisor keeps the comparable over time.



Benchmarks – How do Managers Try to Win

Investment managers can try to “beat” the benchmark (index) in a couple of ways:

- ❖ Stock Selection – buy only winners and avoid losers.
- ❖ Sector Weighting – overweight sectors that are likely to outperform and underweight the sectors that are likely to underperform.
- ❖ One way you do not want your investment manager to try to “beat” the benchmark is to purchase securities that are not included in the benchmark universe (i.e. Large Cap U.S. manager purchasing international stocks).



Top Mutual Funds-3 Months, 1Yr, 3Yr and 5Yr

3 MONTHS

- ProFunds:Mobile Tel;Svc 36.2%
- ProFunds:Telecomm;Inv 20.8%
- ProFunds:Telecomm;Svc 20.4%
- ProFunds:Biotech;Inv 14.6%
- ProFunds:Biotech;Svc 14.3%
- Fidelity Sel Mltimedia 10.9%
- Vanguard Tele Indx;Adm 10.8%
- Fidelity Sel Telecomm 10.7%
- Fidelity Adv Telecom;I 10.7%
- Fidelity Adv Telecom;A 10.6%

Top Mutual Funds-3 Months, 1Yr, 3Yr and 5Yr

1 YEAR

- ProFunds:Biotech;Inv 86.1%
- ProFunds:Biotech;Svc 84.3%
- Direxion:M NAS BI 2x;Inv 71.0%
- Rydex:NASDAQ 2x;A 65.3%
- Rydex:NASDAQ 2x;H 65.2%
- ProFunds:UltraNASDAQ;Inv 64.8%
- Rydex:NASDAQ 2x;C 64.0%
- ProFunds:UltraNASDAQ;Svc 63.2%
- ProFunds:Mobile Tel;Inv 61.0%
- Fidelity Adv Biotech;I 60.9%

Top Mutual Funds-3 Months, 1Yr, 3Yr and 5Yr

3 YEARS

- PIMCO:RE RI Rtn;Inst 38.9%
- PIMCO:RE RI Rtn;P 38.8%
- PIMCO:RE RI Rtn;A 38.4%
- PIMCO:RE RI Rtn;D 38.4%
- PIMCO:RE RI Rtn;B 37.4%
- PIMCO:RE RI Rtn;C 37.3%
- Direxion:M NAS BI 2x;Inv 36.9%
- Rydex:NASDAQ 2x;A 34.9%
- Rydex:NASDAQ 2x;H 34.9%
- ProFunds:UltraNASDAQ;Inv 34.9%

Top Mutual Funds-3 Months, 1Yr, 3Yr and 5Yr

5 YEARS

- Oceanstone Fund 36.4%
- PIMCO:Extend Dur Bond 18.6%
- Direxion:M 10Y BI 2x;Inv 16.6%
- RBB:RBP Long/Sh Eq;l 15.7%
- RBB:RBP Long/Sh Eq;Inv 15.3%
- Rydex:Gv LB 1.2x Str;Inv 14.4%
- Wasatch:Hois US Tr;Inv 14.2%
- Rydex:Gv LB 1.2x Str;A 14.1%
- Delaware Ext Dur Bd;Inst 13.9%
- Rydex:Gv LB 1.2x Str;Adv 13.8%

Top Mutual Funds-3 Months, 1Yr, 3Yr and 5Yr

3 Months:	<u>ProFunds:Mobile Tel;Svc</u>	36.2%
1Yr :	<u>ProFunds:Biotech;Inv</u>	86.1%
3Yr :	<u>PIMCO: Ext Duration Bond</u>	38.9%
5Yr :	<u>Oceanstone Fund – Mid Cap</u>	36.4%

Source: WSJ "Smart Money"

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THAT CONCLUDES OUR 2 DAY INTERNATIONAL SALES MEETING. WE COVERED OUR 9 NEW PRODUCT INTROS...



OUR NEW SALES PROCESS...

YOUR NEW COMPENSATION & SALES TERRITORY PLANS... RECENT REGULATORY ISSUES... OUR NEW POSITION STATEMENT... CRM SYSTEM CHANGES...



AND OUR COMPLETE SHIFT IN VERTICAL MARKET FOCUS.



WE'LL POST EVERY BIT OF THIS ON OUR INTRANET JUST-IN-TIME FOR EVERYTHING TO CHANGE AGAIN. NOW...



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THANK YOU!

**We appreciate the opportunity to make
a presentation today!**

**Enjoy the remaining sessions at the
IPPPFA Annual Conference.**