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A Wealth of Information: How to Read a Mutual Fund Prospectus

With more than 7,400 mutual funds to consider in the United States alone, some investors may feel overwhelmed by the thought of deciding which ones to select for their portfolios. At the same time, most mutual fund-owning households base their purchase decisions on these measures: historical performance (94%), investment objectives and risk potential (91%), and fees and expenses (90%).¹



Fortunately, reading a mutual fund prospectus is a key way to learn important details about your investment options while learning more about how they may help you pursue your financial goals.

What's in a Prospectus

A prospectus is a document containing specific details about the fund's unique characteristics, designed to help investors better understand their options and make well-informed decisions. The Securities and Exchange Commission requires investment companies to provide prospective investors with a free, up-to-date prospectus for each fund they offer. Although the exact content of each prospectus varies from fund to fund, all prospectuses must include the same general information. (A shorter version, called a *summary prospectus*, contains much of the same information discussed here in an abbreviated format.)

Here's an overview of what you'll find in a fund prospectus — and why you should care.

Investment Objective, Strategies, and Risks

A fund's investment objective describes the financial goal it targets on behalf of shareholders. For example, the objective could be capital appreciation (i.e., providing asset growth), income (providing interest or dividend payments), or a combination of the two.

The section of a prospectus highlighting a fund's investment strategies, on the other hand, explains how the fund will invest its holdings to attempt to pursue its objectives. It typically identifies the geographic regions, industries, and types of securities the fund focuses on. It also lets you know whether the fund is actively managed or passively tracks the performance of a market index.

In addition, a prospectus lists the types of risk a particular fund or group of funds may entail, such as market risk, credit risk, inflation risk, and business or issuer risk. (*See table for definitions.*) This information clarifies exactly what types of risk you may encounter by adding a fund to your portfolio. All investments are subject to market fluctuations, risk, and loss of principal. Investments, when sold, may be worth more or less than their original cost. Investments seeking to achieve higher yields also involve a higher degree of risk.

Types of Mutual Fund Risk



Business or issuer risk: The risk that a company in which a fund invests will go out of business or suffer another significant financial setback.



Inflation risk: The risk that the value of investments will not increase in step with rising prices.



Concentration risk: The risk that a fund's holdings may not be well diversified.



Interest-rate risk: The risk that a fund's holdings will lose value if interest rates rise.



Credit risk: The risk that a debt investment's issuer will not be able to make interest payments or repay the principal.



Market risk: The risk of loss arising from overall price declines in the broader market.

Fees, Performance, and Management

The fees you pay to invest in mutual funds, such as sales charges and operating expenses, can have a direct impact on your net investment returns. To offer insight into how they may influence your portfolio's bottom-line performance, a fund's prospectus specifies the types and amount of fees the fund charges. Each prospectus must include a table illustrating the effect of those fees on a hypothetical investment over different time periods. You can also find details about a fund's management team, rules for buying and selling shares, dividend payment policies, and other helpful information.

A prospectus is required to disclose the fund's performance during the past 10 years (or since inception) and to compare its performance with that of a relevant market index. Keep in mind, however, that the performance of an index is not indicative of the performance of any particular investment,

individuals cannot invest directly in an index, and past performance is not a guarantee of future results.

Mutual funds are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional.

1) Investment Company Institute, 2021–2022

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