

# UNDERSTANDING MUTUAL FUNDS

ValMark Securities, Inc. ("ValMark") appreciates the confidence that you have placed in your financial advisor and our organization. In an effort to further that confidence, ValMark has developed this *Mutual Fund Brochure* to help clients, such as yourself, to better understand the various types of mutual funds and mutual fund classes. This brochure is not intended to replace the fund's prospectus or discussions with your financial advisor, but rather, is provided as an additional guide to helping you make a wise and informed investment decision.



## A. INTRODUCTION

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# UNDERSTANDING MUTUAL FUNDS

*Basic Definition* - A Mutual Fund is a company that invests in a diversified portfolio of securities. People who buy shares of a mutual fund are its owners or shareholders. Their investments provide the money for a mutual fund to buy securities such as stocks and bonds.

There are three basic types of mutual funds – stock funds (also called equity funds), bond funds, and money market funds.

**Stock Funds:** Stock funds invest primarily in shares of stock issued by U.S. or foreign companies. When you buy shares of a stock fund, you essentially become a part owner of each of the securities in your fund's portfolio. Over time, stocks historically have performed better than other investments in securities, such as bonds and money market instruments. Of course, there is no guarantee that this historical trend will be true in the future. If the companies owned by the stock fund are successful, then shareholders can profit in two ways: the stock may increase in value, or the company can pass along its profits to the shareholders in the form of dividends. Since the value of stock funds is based, in part, on the increase and decrease of the value of companies that the stock fund owns, the upswings and downturns of the stock market can severely affect the value of stock funds. If the companies owned by the stock fund fail, then shareholders can lose the entire value of the shares of those companies.

**Bond Funds:** Bond funds invest primarily in securities known as bonds. A bond is a type of security that resembles a loan. When a bond is purchased, money is lent to the company, municipality, or government agency that issued the bond. In exchange for the use of this money, the issuer promises to repay the amount loaned on a specific maturity date. In addition, the issuer typically promises to make periodic interest payments over the life of the loan.

A bond fund share represents ownership in a pool of bonds and other securities comprising the fund's portfolio. Although there have been past exceptions, bond funds tend to be less volatile than stock funds and often produce regular income. Like stock funds, however, bond funds do have risk and can make or lose money.

**Tax-Free Bonds:** With most bond funds, the income that you receive is taxable as ordinary income. However, some funds invest in bonds whose interest payments are free from federal and/or state income tax (tax-exempt bond funds may, however, be subject to capital gains taxes). The tax-exempt benefit typically means that the income from these bond funds is lower than that of comparable taxable funds. But if you compare the yield after taxes, a tax-

free fund may be a better choice, depending on your tax bracket. Please also note tax-free funds may be subject to the Alternative Minimum Tax.

**Money Market Funds:** Money market funds invest, mainly, in a pool of short-term interest bearing securities. A money market instrument is a short-term IOU issued by the U.S. government and its agencies, U.S. corporations, and state and local governments. Money market instruments have maturity dates of less than 13 months and must invest in U.S. Treasury issues and only the highest rated privately issued securities. These restrictions help minimize the risk of money market funds. However, money market funds do not guarantee that you will receive all of your money back. While money market funds may invest in U.S. Treasury issues, the U.S. government does not insure them.



## B. WHAT IS A MUTUAL FUND?

# UNDERSTANDING MUTUAL FUNDS

When purchasing mutual funds, you will have the opportunity to choose between several different "classes." Each class represents a similar interest in the mutual fund's portfolio. The principal difference between the classes is that the mutual fund charges different fees and expenses depending upon the class that you choose.

Most mutual funds offer at least three different share classes – Class A, Class B, and Class C (many funds offer other share classes as well but these are the most common). If you are thinking about buying a mutual fund, it is important for you to understand the differences between these share classes. Before examining the different mutual fund share classes, it is important to first understand a few key terms:

**Front-End Sales Charge** – This fee is charged when you purchase mutual fund shares. For example, suppose you wish to spend \$1,000 to purchase Class A shares, and the mutual fund imposes a front-end sales charge of 5%. You will be charged \$50 on your purchase, and you will receive shares with a market value of \$950.

**Contingent Deferred Sales Charge or CDSC** – This fee is charged when you sell your mutual fund shares. For example, if you redeem shares valued at \$1,000, and the mutual fund imposes a CDSC of 1%, you would receive \$990. The CDSC normally declines the



## C. UNDERSTANDING MUTUAL FUND CLASSES

longer the shares are held and eventually is eliminated after a number of years, often in the seventh year that you own the shares.

**Asset-Based Sales Charges** – These are fees that you would not directly pay, but which are taken out of mutual fund's assets to pay to market and distribute its shares. For example, asset-based sales charges could be used to compensate a broker/dealer for the sale of mutual fund shares, for advertisements, and to print copies of the prospectus. Asset-based sales charges include "Rule 12b-1" fees, which are dedicated to these types of distribution costs.

**Expense Ratio** – A mutual fund's expense ratio measures the fund's total annual expenses expressed as a percentage of the fund's net assets. For example, an expense ratio of 1% represents an annual charge to the fund's net assets – including your proportional interest in those assets – of 1% every year. The expense ratio includes the asset-based sales charge and other ongoing fees that are deducted from a mutual fund's assets to pay for the services of

the mutual fund's investment adviser or transfer agent or for other expenses. Front-end sales charges and CDSCs are not included in the expense ratio because they are charged directly to the investor.

The fee table in the front of a mutual fund's prospectus provides the amount of a mutual fund's expense ratio and its front-end sales charge and CDSC. These fees and expenses can vary widely from fund to fund or from fund class to fund class. Because even small differences in expenses can make a big difference in your return over time, you should review the fund's fee table in the prospectus to determine the precise amount of the fund's fees and expenses.

### Sample Fund Operating Expenses

	Class A	Class B	Class C
Management Fees	0.97%	0.97%	0.97%
Distribution and/or Service (12b-1) Fees	0.30%	1.00%	1.00%
Other Expenses	0.46%	0.50%	0.48%
<b>Total Annual Fund Operating Expenses</b>	<b>1.73%</b>	<b>2.47%</b>	<b>2.45%</b>

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## D. MUTUAL FUND SHARE CLASSES



**Class A Shares:** Class A shares typically charge a front-end sales charge. When you buy Class A shares with a front-end sales charge, a portion of the dollars you pay is not invested. Class A shares may impose an asset-based sales charge, but it generally is lower than the asset-based sales charge imposed by the other classes.

A mutual fund may offer you discounts, called breakpoints, on the front-end sales charge if you:

- Make a large purchase;
- Already hold other mutual funds offered by the same fund family; or
- Commit to regularly purchasing the mutual fund's shares.

Breakpoints for Class A shares are discussed at greater length later in this brochure. If you are buying Class A share, be sure to ask your financial adviser whether any breakpoint discounts are available to you.



**Class B Shares:** Class B shares typically do not charge a front-end sales charge, but they do impose asset-based sales charges that may be higher than those that you would incur if you purchased Class A shares. Class B shares also normally impose a contingent deferred sales charge (CDSC), which you pay when you sell your shares. For this reason, these should not be referred to as "no-load" shares. The CDSC normally declines and eventually is eliminated the longer you hold your shares. Once the CDSC is eliminated, Class B shares often then "convert" into Class A shares. When they convert, they will begin to charge the same asset-based sales charge as the Class A shares.

Class B shares do not impose a sales charge at the time of purchase. So unlike Class A purchases, all of your dollars would be immediately invested. But your expenses, as measured by the expense ratio, may be higher. You also may pay a sales charge when you sell your Class B shares.

If you intend to purchase a large amount of Class B shares, you may want to discuss with your financial adviser whether Class A shares would be preferable. The expense ratio charged on Class A shares is generally lower than for the Class B shares, and the mutual fund may offer large-purchase breakpoint discounts from the front-end sales charge for Class A shares.

To determine if Class A shares may be more advantageous refer to the mutual fund's prospectus, which may describe the purchase amounts that qualify for a breakpoint discount.



**Class C Shares:** Class C shares usually do not impose a front-end sales charge on the purchase, so the full dollar amount that you pay is immediately invested. Often Class C shares impose a small charge if you sell your shares within a short time of purchase – usually one year. Class C shares typically impose higher asset-based sales charges than Class A shares, and since their shares generally do not convert into Class A shares, their asset-based sales charge will not be reduced over time. Class C shares are often used for asset-allocation purposes.

Class C shares do not impose a sales charge at the time of purchase, but they may impose a CDSC or other redemption fees. Additionally, in most cases your expense ratio would be higher than Class A shares, and even higher than Class B shares if you hold the investment for a long time.

**Other Share Classes:** While the previously discussed mutual fund share classes are the most commonly sold, additional variations of share classes exist, which may utilize a front-end sales charge, back-end sales charge or level-load sales charge structure. For each mutual fund's particular share class information, you should refer to the fund's prospectus.

# UNDERSTANDING MUTUAL FUNDS

Mutual funds often offer discounts on front-end sales charges or loads for larger investments. Because these discounts apply to front-end sales charges, they are most typical on purchases of Class A shares. The investment levels at which the discounts become available are called "breakpoints."

For example, a mutual fund might charge you a front-end sales load of 5.75% for all purchases of less than \$50,000, but reduce the load to 4.50% for investments between \$50,000 and \$99,999, and further reduce or eliminate the sales load for even larger investments.

The information provided in this section is intended to explain how breakpoints work and what you need to know to make sure you are charged the lowest possible front-end sales load.



## E. MUTUAL FUND BREAKPOINTS

**How Breakpoints Work:** When your dollar amount of mutual fund purchases reaches a specified level, called a breakpoint, you are entitled to pay a smaller sales load. For example, a purchase of \$49,500 in mutual fund shares may be charged a front-end sales load of 5.75% or \$2,846.25, while a purchase of \$50,000 in fund shares might be charged a sales load of 4.50% or \$2,250. In this example, by choosing to invest \$500 more in funds, you would have \$596.25 more invested in fund assets. Typically, there are several breakpoints, and if you invest more and reach each of these thresholds, the greater the reduction in the sales load.

### Sample Breakpoint Schedule

Amount Invested	Sales Charge
Less than \$50,000	4.75%
\$50,000 but less than \$100,000	4.50%
\$100,000 but less than \$250,000	3.50%
\$250,000 but less than \$500,000	2.50%
\$500,000 but less than \$1 Million	2.00%
\$1 Million or more	None

*Mutual fund breakpoints may vary by mutual fund companies. Your ValMark Registered Representative can explain what reduced sales charge schedule your fund(s) may offer.*

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While you may be entitled to a lower front-end sales load based on a single mutual fund transaction if the dollar size of the transaction exceeds one or more breakpoints, you may also be entitled to receive a breakpoint discount based on rights of accumulation or by using a letter of intent.

**Rights of Accumulation:** A right of accumulation (ROA) typically gives you a discount on your current mutual fund purchases by combining both your current and previous fund transactions to reach a breakpoint. For example, if you are investing \$10,000 in a fund today, but previously had invested \$40,000, those amounts can be combined to reach a \$50,000 breakpoint, which will entitle you to a lower sales load on your \$10,000 purchase.

Be sure that you tell your financial advisor about all of your mutual fund holdings as well as those of your immediate family members – including holdings at other brokers or with the mutual fund itself.



## F. RIGHTS OF ACCUMULATION AND LETTERS OF INTENT

**Letter of Intent:** What if you can't immediately invest the minimum amount necessary to trigger a breakpoint discount? If you are planning to make additional investments over the coming months, you might still be able to obtain a reduced sales charge by means of a letter of intent (LOI). An LOI is a statement you sign that expresses your intent to invest an amount over the breakpoint within a given period of time specified by the fund. Many fund companies permit you to include purchases completed within 90 days before the LOI is signed and within 13 months after the LOI is signed in reaching the dollar amount of the breakpoint threshold. If you fail to invest the amount stated in your LOI, the fund could retroactively collect the higher fee. If you expect to invest regularly in a fund with a front-end sales load, it is worth finding out if a LOI can help you qualify for a reduced charge.

**Family Discounts:** In the case of either ROAs or LOIs, you usually may credit mutual fund transactions in other related accounts, in different mutual fund classes, or in different mutual funds that are part of the

same fund family, toward your discounts. For example, a fund may allow you to get a breakpoint discount by combining your fund purchases with those of your spouse or children. You also may be able to credit mutual fund transactions in retirement accounts, educational savings accounts, or in accounts at other brokerage firms.

Before making a mutual fund purchase, be sure to review your account statements and those of your immediate family members to determine whether the combined total investments that you and your family members have in a particular mutual fund family may qualify you for a breakpoint discount.

Each mutual fund and family of funds set their own breakpoints and the conditions through which discounts are available. You can find additional information on breakpoints in the mutual fund's prospectus or Statements of Additional Information and on many mutual fund company web sites.