What Is A Mutual Fund?

A mutual fund is a pool of investments used to invest in a large diversified portfolio of securities that will be managed by a professional management. An investor in a mutual fund is a shareholder who buys shares of the fund. Each share represents a proportionate ownership in all the fund's underlying securities. The securities are selected by a professional investment manager to meet a specified financial goal, such as growth or income.

Why Invest in A Mutual Fund?

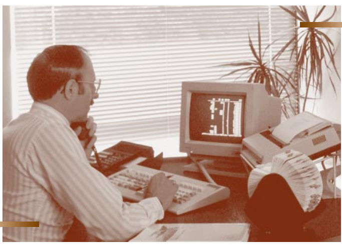
Mutual funds make saving and investing simple, accessible and affordable. The advantages of mutual funds include professional management, diversification, choice, liquidity, convenience and ease of record keeping.

• ***Professional Management***

The money accumulated in a mutual fund is managed by professionals who decide on behalf of shareholders on investment strategy. These professionals choose investments that best match the fund's objectives as described in the prospectus. Their investment decisions are based on extensive knowledge and research of market conditions and the financial performance of individual companies and specific securities. As economic conditions change, the fund may adjust the mix of its investments to adopt a more aggressive or a more defensive strategy to meet its investment objective.

• ***Diversification***

Fund managers typically invest in a variety of securities seeking portfolio diversification. A diversified portfolio helps reduce risk by offsetting losses from some securities with gains in others. The average investor would find it expensive and difficult to construct a portfolio as diversified as that of a mutual fund. Mutual funds provide an economic way for average investors to obtain the same kind of professional money management and diversification of investments that is available to large institutions and wealthy investors.



- *Variety*

There are a wide variety of investment objectives, from conservative to aggressive, and investing in a wide range of securities. There are also specialty or sector funds that invest primarily in a specialized segment of the securities markets.

- *Accessibility*

Mutual fund shares are easy to buy and to sell. Investors may purchase fund shares with the help of an investment professional (e.g., a broker, financial planner, bank representative, or insurance agent) or directly, based on the investor's own research and knowledge. Investment professionals provide services to investors—analyzing the client's financial needs and objectives and recommending appropriate funds.

Types of Mutual Funds

Mutual funds are either close-ended or open-ended. A close-ended mutual fund issues only a certain number of shares. After the shares are sold and the money is invested in its portfolio of securities, trading of the fund's shares can take place. The company is not obligated to redeem its shares or issue more shares. An investor who no longer wants to hold shares in the fund may simply sell them in the market. An open-end mutual fund, by contrast, is constantly offering new shares to the public and redeeming its outstanding shares. There is no limit to the number of shares that can be issued. For the most part, open-ended fund shares are bought and sold directly through the fund itself or its agents, not over-the- counter or on an exchange.

There are four basic types of mutual funds: stock (also called equity, which invest mainly in stocks), bond (which invest mainly in bonds), hybrid—which invest in a mix of stocks and bonds—and money market (which invest mainly in short-term instruments). Money market funds are referred to as short-term funds because they invest in securities that generally mature in about one year or less, whereas stock, bond, and hybrid funds are known as long-term funds.

1. Stock Funds:

- **Income Equity Funds** seek income by investing primarily in equity securities of companies with good dividends. Capital appreciation is not an objective.

- **Growth Funds** invest primarily in common stocks of well-established companies with the potential for capital appreciation. These funds' primary aim is to increase the value of their investments (capital gain) rather than generate a flow of dividends.

- **Growth and Income Funds** attempt to combine long-term capital growth with steady income dividends. These funds pursue this goal by investing primarily in common stocks of established companies with the potential for both growth and good dividends.

- **Aggressive Growth Funds** invest primarily in common stock of small, high growth companies with potential for capital appreciation.

• **Sector Equity Funds** seek capital appreciation by investing in companies in related fields or specific industries, such as financial services, health care, natural resources, technology, or utilities.

• **Regional Equity Funds** invest in equity securities of companies based in specific world regions, such as Europe, Latin America, the Pacific Region, or individual countries.

• **Global Equity Funds** invest primarily in worldwide equity securities.

• **Emerging Market Equity Funds** invest primarily in equity securities of companies based in emerging / developed countries.

2. Bond Funds

• **Corporate Bond-General Funds** seek a high level of income by investing in corporate bonds and have no explicit restrictions on average maturity.

• **Global Bond-General Funds** invest in worldwide debt securities and have no stated average maturity or an average maturity of more than five years.

• **Government Bond-General Funds** invest at least two-thirds of their portfolios in government securities and have no stated average maturity.

• **High-Yield Funds** seek a high level of current income by investing at least two-thirds of their portfolios in lower-rated corporate bonds (Baa or lower by Moody's and BBB or lower by Standard and Poor's rating services).

3. Hybrid Funds

• **Asset Allocation Funds** seek high total return by investing in a mix of equities, fixed-income securities and money market instruments. These funds are required to strictly maintain a precise weighting in asset classes.

• **Balanced Funds** invest in a specific mix of equity securities and bonds with objectives of conserving principal, providing income and achieving long-term growth of both principal and income.

• **Flexible Portfolio Funds** seek high total return by investing in common stock, bonds, other debt securities and money market securities. Portfolios may hold up to 100 percent of any one of these types of securities and may easily change from one asset to another, depending on market conditions.

• **Income Mixed Funds** seek a high level of current income by investing in a variety of income-producing securities, including equities and fixed-income securities. Capital appreciation is not a primary objective.

4. Money Market Funds

• **Money Market-Government Funds** invest principally in short-term Treasury obligations and other short-term financial instruments issued or guaranteed by the government and its agencies.

• **Money Market-Non-Government Funds** invest in a variety of money market instruments, including certificates of deposit of large banks, commercial paper and banker's acceptances.

Before You Buy

Before investing in a mutual fund, the investor must ask himself/ herself several questions in order to choose the right fund that matches his/her investment objectives.

• *What Are The Investment Goals?*

The choice of the investments should always be driven by what the investor wants to do with the money. He/she may have a general, long-term goal such as enough money for retirement, or a precise near-term goal such as accumulating money for a down payment on a house. Investor may want an investment that provides current income or one that can serve emergencies. Taking the time to figure out the goals will help the investor to choose the right investments.

• *When Do You Need The Money?*

The investor must set a time for achieving his/her goals. This is important because different time horizons require different investment strategies. The sooner the investor needs the money, the safer and more accessible he/she wants that money to be. In contrast, the longer the investor can leave the money invested, the less he/she needs to worry about ups and downs in the value of the investment and the more he/she could focus on the goal of earning a higher return over time.

After determining the investment goal and time horizon, the investor can choose the fund that best matches his/her financial goals and objectives from a wide varieties of mutual fund types.

Risk and Risk Tolerance

For most investors, risk represents the chance of losing money. This is a valid concern since the prices of shares in stock and bond funds will reflect inevitable fluctuations in the value of their portfolio holdings—up and down. The investor risk tolerance simply refers to his/her willingness to accept downward fluctuations in the principal value. This risk, which we can call "market risk," is one of three major types. The others are credit and inflation risk.

Market Risk: Stocks. Many factors can cause stock prices to fluctuate: actual or anticipated developments within a particular company or industry; changes in the outlook for the economy as a whole; and shifts in investor attitudes toward the stock market in general, from optimism to pessimism, for example.

Market Risk: Bonds. Bond prices fluctuate with changes in interest rates, rising when interest rates fall and falling when interest rates rise. The longer the maturity of the bond or bond funds, the more the price will rise or fall in response to a given change in rates.

You will find that some of the risks of overseas investing are the same as you would have in domestic securities. There are however others that differ from domestic markets, such as having illiquid markets, political and economic instability, and volatility of currency exchange rates, that are generally of greater concern when investing abroad.

Before investing overseas, you should understand the risks as well as the opportunities and be willing to accept the possibility of incurring substantial declines, especially in emerging market securities in order to realize the longer-term benefits.

Inflation Risk. All investments are subject to this risk, which is the erosion in the purchasing power of the money invested due to rising prices. Any level of inflation above zero means that a future dollar is worth less than a present one. Therefore, an important investment goal is to earn a rate of return that exceeds inflation.

Credit Risk: the risk that an obligation will not be paid.

Finding Funds to Match The Investment Objectives

After the investor has defined his/her financial goals and had a basic understanding of some of the risks, which would help him/her in choosing a specific fund, the investor will probably want to keep part of the money secured and accessible, i.e. part invested for income and part for growth.

Safety: Investing for safety means that the investor's main concern is to protect the principal (the initial amount invested) from loss. Only money market mutual funds can maintain a stable share price although there can be no assurance that they will be able to do so. Prices of other funds vary- some modestly, some to a greater extent.

Money funds, which invest in very short-term, high-quality securities, are the lowest-risk investment among all mutual funds, but they also usually provide the lowest returns. When interest rates rise, the fund's yield should also rise fairly quickly, but when rates fall, so will the fund yield.

Among mutual funds, money funds are the best choice for safety. If the investor can accept modest price fluctuations, however, shorter bond funds should provide a higher income return and the potential for a higher overall return.

Income: If the investor's main objective is a reasonable level of monthly income, he/she should emphasize investments in bond or fixed-income funds. Bonds represent loans to governments or corporations, which in turn must pay interest to the investor over the life (or maturity) of the bond. Which bond fund you choose depends on how much income you wish to earn and how well you tolerate share price increases and decreases - risk/reward trade-off.

Higher income usually accompanies longer maturities, and the longer a bond fund's maturity, the higher the risk in the form of greater swings in the fund's share price. If the investor wants to keep price swings to a modest level, consider a bond fund with a weighted average maturity under five years and high overall credit quality. But if the investor can tolerate price changes in exchange for higher income he/she must choose a longer-term fund or perhaps one with lower average credit quality.

Growth: Growth means growth of capital. If the investor is investing now to build a reservoir of money for the future - at least ten years from now- consider investments in stock funds. Stocks represent ownership of a company, so if the company prospers, its stock price should rise. While stocks have the greater potential market risk, they also have the lowest inflation risk and offer the highest potential for growth over time.

Stock funds come in every imaginable variety. If the investor is a conservative one, he/she has to look for a fund that includes income among its main objectives; such funds tend to have more moderate price fluctuations than ones that de-emphasize income. Likewise, funds that invest across a wide variety of industries should be less volatile than ones in a narrow sector, such as technology or energy.

Mutual Fund Distributions

Dividend distributions come primarily from the interest and dividends earned by the securities in the fund's portfolio after expense.

Capital gain distributions represent the fund's net gains from the sale of securities held in its portfolio for more than one year. When gains from these sales exceed losses, they are distributed to shareholders.

Tax Considerations

Taxes on the funds distributions differ from one country to another, it depends on the country's tax rules and regulations. In Egypt all distributions made by mutual funds are tax exempt.

Evaluation of Fund's Performance, Fees and Management

After the investor has determined his/her investment objectives, risk tolerance and is familiar with the types of funds and their objectives the next step is to evaluate the fund's performance, fund fees and the fund management.

• *Fund Performance:*

Unless the investor is familiar with the risks involved in an investment, he/she will not know what to expect from the fund's performance, and he/she will not know how to properly evaluate it. In general, there is a tradeoff between the level of risk the investor decides to assume and his/her opportunity for reward.

Although past performance cannot predict future results, looking at performance will give a good idea on how this fund has behaved in different market conditions and how it was compared to other relevant performance measures. For example: investors can review the total returns for the past 10 years, investor can compare the percentage change in the **Net Asset Value (NAV)** from year to year over the last 10 years with an appropriate market index. Funds with a good performance are the ones with an annual percentage change in the **(NAV)** equal or exceeding the annual percentage change in the index. Funds with a bad performance are the ones with an annual percentage change in the **(NAV)** less than the annual percentage change in the index.

When comparing the performance of two or more funds, the investor must make sure he/she is comparing apples with apples: that is, make sure the funds have similar investment objectives. For example, stock funds with growth goals tend to be more volatile than bond funds with income goals.

• *Fees and Expenses:*

All mutual funds have fees and expenses that are paid by investors. These costs are important because they affect the return on the investment, particularly over the long term. Before investing in a mutual fund, the investor should decide if the fund's costs are acceptable to him/her.

One way to learn about fees is to read the fund's prospectus (the document describing the fund, available free directly from the fund company or from a broker). Every prospectus contains a fee table. Fees generally fall into two categories—"shareholder fees" and "annual operating expenses." Shareholder fees include any commission paid to brokers when you buy or sell your shares. These commissions are often described as

"front-end loads" (sales charges when you buy) or "back-end loads" (sales charges when you sell). "No-load" funds, as the name implies, do not have front-end or back-end sales charges.

Annual operating expenses pay for the ongoing costs of running a fund—for the services of the fund manager, for example, who selects and oversees the fund's portfolio of securities—and for various fund services, such as recordkeeping, printing and mailing. Both shareholder fees and annual operating expenses are shown in the fund's prospectus.

Remember, however, that fees donot tell the whole story. A fund with lower expenses may perform better than a fund with higher expenses—and the opposite may also be true. Perhaps most importantly, the investor should consider the fund's investment objectives, policies, and risks to make sure they match with his/her own outlook and goals.

- ***Fund Management:***

The investor should consider who is the fund's investment manager? The fund management company is the firm responsible for deciding how, where, and when to invest the fund's assets. The prospectus will also give the investor information about the portfolio manager's background, which will help to evaluate the fund management.

Mutual Funds in Egypt

The take off of the Egyptian Stock Market created the necessary financial climate for establishing several new mutual funds that allow new and different investment possibilities for both (smaller) retail and (larger) institutional investors. Currently there are 21 local close and open ended funds with a total value LE 3.88 billion as of end of June 2003.

The Egyptian government in 1992 introduced Capital Market Law No. 95, which laid down the foundations for future development of the financial sector. A key result of the law was the emergence of mutual funds as a form of investment that is managed by private companies. The funds were launched in concert with leading banks & insurance companies with which individual investors were familiar. As a means of ensuring their credibility in the eyes of investors, the law stated that the mutual funds must have professional management, and the bank or the insurance company must hold 5 per cent of the total assets. In addition, the bank or the insurance companies must remain an investor for the life of the fund.

The decline in the net asset value (NAV) of the majority of mutual funds over the period 1999-2002 was due to the overall decline of the stock market. Fund management companies are trying to beat the downtrend of the market and minimize losses. Nevertheless, the percentage decrease in the NAV of most of the funds was lower than the percentage decrease in the S&P/IFCG or MSCI indexes. During the market downturn, fund managers face a serious problem that some investors withdraw their money from the fund, which enforce the funds to lose their cash, liquidate their bonds holding, increase overdraft from banks and liquidate some of the stocks holding. This problem is mainly due to the investors' unawareness of the workings of the stock market.

To conclude, the Egyptian government is exerting a tremendous effort to develop the capital market to broaden the retail and institutional investor base, which in turn would offer more instruments to the investors and provide more liquidity to the market.