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DATE: Wednesday, April 25, 2007

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Issue 2007-2

FINANCIAL PLANNING ALERT

The ABCs of Mutual Funds

When it comes to investments, mutual funds are the products-of-choice for individual investors. **At the end of 2005 over $9.5 trillion was invested in over 23,000 mutual funds.** Mutual funds are popular because they provide investors a simple way to invest in a wide selection of stocks and bonds without directly purchasing individual stocks or bonds. For example, buying just one share of an S&P 500 Index mutual fund allows you to invest money in 500 different companies without actually having to purchase each individual company stock.

Despite the popularity of mutual funds, many investors do not fully understand the share class structure of mutual funds. The share class can determine the rate of fees and commissions charged and how easy it will be for an individual to sell the fund in the future. **Without a basic knowledge of share classes it is easy to make ill-advised decisions that can affect the long-term performance of one's investments.** Even a small difference in fees and commissions paid by the investor can result in a significant difference in a mutual fund's performance.

Most mutual funds are offered with 3 share class options – A, B and C shares. Even if a specific mutual fund is offered through different share classes, it is managed exactly the same for all share classes. The difference between one share class and another is the commission-structure and distribution options.

Mutual fund companies offer brokers a built-in commission as an incentive to sell their particular mutual fund to an investor. This commission is paid by the investor to the broker in different ways. For example, an investor purchasing an A-share fund will pay the broker a huge commission up front when the product is purchased. An investor in a B-share fund will pay the broker a huge commission on the back-end when the fund is sold. The back-end commission is also called the Contingent Deferred Sales Charge (CDSC) and gradually decreases over time. With A, B & C shares, there is usually an additional commission paid to brokers each year called the 12B-1 fee.

Share Class	Front-End Load Commission	Back-End Load Commission	Additional 12B-1 Fee Commission	Annual Expense	Beware
A	**5 - 6% up-front**	None	**Yes - Annually**	Usually lower than B and C shares	Huge front-end commissions paid
B	None	**5%, with gradual decreases each year**	**Yes - Annually**	B and C shares usually the highest	Back-end loads may leave you stuck with a bad fund for years
C	None	**1% for first year**	**Yes - Annually**	B and C shares usually the highest	More distribution flexibility but high annual fees
NO LOAD	None	None	None	Lowest	Low cost doesn't always mean a high quality fund

This information is provided as a general summary. For detailed information about a specific mutual fund refer to the fund prospectus.

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Many mutual fund companies have begun marketing their funds directly to the individual investor, thus by-passing the normal broker channels. Because these companies do not rely on a broker to sell their funds there is no need to include a commission as incentive to the broker. These funds are called "No-Load" because there is no commission included in the mutual fund's expense. **No-Load funds generally have the lowest annual costs of all mutual fund share classes.** Some companies also offer hybrid share classes called "Load-Waived" and "Low-Load" funds, which have a reduced commission. It is important to remember that low-cost does not always mean one will get a high-quality fund.

The following hypothetical example demonstrates how a fund's share class and fees can impact the long-term investment performance of an account:

> Bob and Joe are both 40 years old and have IRAs worth $50,000 each. Bob and Joe each make annual contributions to their IRAs in the amount of $4,000.
>
> Bob's account is invested in high-cost funds, including A, B & C share funds, with fees and commissions that average 2.5% per year. The average investment performance of the funds, before-fees, is 8% per year. **At age 65, Bob's IRA will be worth $524,368.**
>
> Joe's account is invested in lower-cost funds, including no-load funds, with fees that average 1.5% per year. The average investment performance of the funds, before-fees, is 8% per year. **At age 65, Joe's IRA will be worth $634,848, more than $110,000 higher than Bob's IRA.**

When selecting a mutual fund, the most important aspects to evaluate are the fund's fundamental indicators such as asset class, risk, historical performance, and peer comparison. But an individual should never overlook the share-class of a fund as this can be one of the most significant factors affecting a fund's long-term performance. Choosing a high-quality fund that has low fees and commissions can potentially add 1-2% of yearly performance compared to a similar fund with high fees and commissions. **When it comes to mutual funds it really pays to know your ABCs!**

If you have invested in mutual funds without considering how the share class may be affecting your account, Mersereau & Lazenby, L.L.C. can help. We can evaluate your current portfolio or provide professional investment management services with your interests at heart. As a fee-only provider we do not receive a commission on any product or service. This allows us to provide financial planning and investment management that is independent and objective.