

KIDS AND MUTUAL FUNDS:

EDUCATING AND INVESTING

By John Markese

A diversified, no-load, large-cap stock fund that has a growth objective fits the investment profile of most young investors and is likely to appeal to their interest through knowledge of the companies held by the fund.

How many of you wish that someone would have taught you at an early age about investing and helped you make some wise investments in your youth?

You may now be parents and grandparents searching for ways to educate your children and grandchildren on saving and investing while making some appropriate investments for them. Mutual funds are an obvious choice for young investors, primarily because they usually offer a diversified and simple way to start and build an investment for young investors. But be prepared to do or organize much of the education yourself.

And then there is the decision of just what fund to choose.

One time-honored way to interest children in investing is to find stocks of companies that make products or produce services that children are likely to be familiar with and enthusiastic about: McDonald's, Disney, Sony, Nike, Mattel, etc. The older the child, the broader the familiar-product universe and the easier it is to make the connection between products/services, companies, stocks and investment rewards. Since children are more likely to identify with products of larger, more well-known firms and need to be diversified as all investors should, have a long investment horizon and have growth as the primary investment objective, the appropriate mutual fund type becomes more apparent.

A diversified, no-load, common stock fund that concentrates on large-capitalization stocks, and has an investment objective of growth, meets the combined goals of interesting a young investor and matching the investment profile of the typical young investor.

Table 1 lists mutual funds that were in the top of the growth investment category over one, three and five years, as reported in AAI's *Quarterly Low-Load Mutual Fund Update*. These are all growth funds specializing in large stocks; the list excludes sector funds—funds that concentrate in one or two industries, and funds that specialize in small stocks—companies with products children would be less likely to recognize by brand name.

Two funds were added to the list in Table 1, the first because of its unique focus, and the second as a benchmark alternative. Stein Roe Young Investor Fund, as its name implies, is structured to invest with the young in mind. According to its prospectus, it invests in companies that affect children and teenagers. Companies that affect the lives of young investors and companies that young investors might identify with, however, may not be totally coincident. The fund has an unusual second objective: education. The fund makes available educational materials on mutual funds, personal finance and basic economics aimed at the younger investor.

The Vanguard 500 Index is the second fund added to the list. Because this fund invests in larger companies in the industrial, financial, transportation and utility sectors, some of which pay dividends, it generates some income, about 1% annually, which causes it to fall just out of the growth category and into the growth and income category. However, with its passively managed index format, broad diversification, low cost and a whole lot of companies that young investors would recognize, it is certainly a reasonable alternative.

As is evident in Table 1, these funds have been on fire. Fidelity Growth

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TABLE 1. MUTUAL FUNDS FOR YOUNG INVESTORS: PERFORMANCE CHARACTERISTICS

| Fund Name (Ticker) | Total Return (%) | | | Annual Return (%) | | | Risk Index | Expense Ratio (%) |
|---------------------------------------|------------------|-----------------|-----------------|-------------------|-------------|------------|------------|-------------------|
| | Last Quarter | Last 2 Quarters | Last 3 Quarters | One Year | Three Years | Five Years | | |
| Fidelity Growth Company (FDGRX) | -8.1 | 9.0 | 57.6 | 63.9 | 38.0 | 31.2 | 1.51 | 0.74 |
| Harbor Capital Appreciation (HACAX) | -7.6 | 4.1 | 33.6 | 29.2 | 32.2 | 28.7 | 1.23 | 0.66 |
| INVESCO Blue Chip Growth (FLRFX) | -0.1 | 7.6 | 41.2 | 36.4 | 32.1 | 29.9 | 1.20 | 1.03 |
| Janus Fund (JANSX) | -6.7 | 3.0 | 28.9 | 26.9 | 31.7 | 27.9 | 1.09 | 0.84 |
| Preferred Growth (PFGRX) | -7.6 | 3.9 | 34.1 | 29.9 | 31.5 | 27.4 | 1.20 | 0.83 |
| Reynolds Blue Chip Growth (RBCGX) | -8.2 | -1.9 | 30.8 | 26.4 | 34.2 | 33.0 | 1.23 | 1.50 |
| Stein Roe Young Investor (SRYIX) | -9.0 | -0.1 | 28.0 | 16.3 | 20.3 | 25.5 | 1.13 | 1.18 |
| Vanguard Growth Equity (VGEQX) | -3.5 | 9.4 | 52.9 | 51.4 | 38.8 | 33.1 | 1.29 | 0.92 |
| Warburg Pincus Capital Apprec (CUCAX) | -6.6 | 6.5 | 41.6 | 41.0 | 31.3 | 30.1 | 1.17 | 1.01 |
| Vanguard 500 Index (VFINX) | -2.6 | -0.4 | 14.4 | 7.3 | 19.6 | 23.7 | 0.92 | 0.18 |

Source: AAI's Quarterly Low-Load Mutual Fund Update, July 2000.

Company returned 63.9% over one year, and 31.2% a year compounded annually for five years. All of these funds have averaged over 25% annually for five years, with the exception of the Vanguard 500 Index fund at "only" 23.7%. In this technology-driven market, all of these growth funds have had significant portfolio weightings in technology, including the Stein Roe Young Investor Fund and the Vanguard 500 Index.

Table 2 shows the top five stocks

held by each fund. No surprise—many of these are the same large-cap technology stocks, but with the average growth fund holding about 100 stocks, and 500 in the Vanguard 500 Index, it should be easy to find quite a few stocks that young investors would recognize and be enthusiastic about.

The five-year returns are extraordinary by any standard. Performance like this, however, has attendant risks; these funds are volatile compared to many less growth-

oriented mutual funds (just look at last quarter), and are in a far, far distant risk category than some of the more traditional investments for young investors such as savings accounts and government savings bonds. The risk index in Table 1 measures monthly total return variation over a three-year period for each fund compared to the average for the growth fund category. A risk index of 1.00 would be average, a risk index of 1.51, as in the case of Fidelity Growth Com-

TABLE 2. MUTUAL FUNDS FOR YOUNG INVESTORS: PORTFOLIO CHARACTERISTICS AND FUND INFO

| Fund | Web Address | Total Assets (\$ Mil) | Minimum Investment (\$) | | | | Top 5 Holdings |
|-------------------------------|------------------------|-----------------------|-------------------------|------------|--------------|-----------------|---|
| | | | Initial | Subsequent | UGMA Initial | UGMA Subsequent | |
| Fidelity Growth Company | www.fidelity.com | 37,589 | 2,500 | 250 | na | na | Microsoft, Cisco, Nat Semi, JDS Uniphase, Network App |
| Harbor Capital Appreciation | www.harborfund.com | 8,830 | 2,000 | 100 | 500 | 100 | Microsoft, MCI WorldComm, Cisco, General Elec., Home Depot |
| INVESCO Blue Chip Growth | www.invesco.com | 1,752 | 1,000 | 50 | 250 | 50 | Warner-Lambert, Schwab, America Online, Intel, General Elec. |
| Janus Fund | www.janus.com | 46,217 | 2,500 | 100 | 500 | 50 | Comcast, Time Warner, Cisco, Sun Micro, Tyco Int'l |
| Preferred Growth | www.preferredgroup.com | 844 | 1,000 | 50 | na | na | MCI WorldComm, Microsoft, Cisco, Texas Instruments, Citigroup |
| Reynolds Blue Chip Growth | www.reynoldsfunds.com | 652 | 1,000 | 100 | na | na | Cisco, Intel, America Online, Microsoft, IBM |
| Stein Roe Young Investor | www.steinroe.com | 1,211 | 2,500 | 50 | 100 | 50 | Cisco, Microsoft, MCI Worldcomm, General Elec., Tyco Int'l |
| Vanguard Growth Equity | www.vanguard.com | 282 | 10,000 | 50 | 1,000 | 50 | Cisco, Intel, America Online, Warner-Lambert, Oracle |
| Warburg Pincus Capital Apprec | www.warburg.com | 1,442 | 2,500 | 50 | 500 | 50 | Microsoft, Cisco, AT&T Liberty Media, General Elec., Nextel |
| Vanguard 500 Index | www.vanguard.com | 98,617 | 3,000 | 50 | 1,000 | 50 | General Elec., Cisco, Microsoft, Exxon Mobil, Wal Mart |

pany Fund, translates to a risk 51% higher than the average of the already volatile growth category. The Vanguard 500 Index fund, at 0.92, has a risk index below average. Higher return often is accompanied by higher risk.

The expense ratio, already reflected in the performance numbers, is a measure of the annual cost of having your investment managed professionally through a mutual fund. If you put your own portfolio together, this is what you would save annually. The expense ratio does not include brokerage costs and transaction costs. The average expense ratio for growth funds is 1.07%. It is hard to beat index funds on a cost basis; the

Vanguard 500 Index fund, at a mere 0.18% expense ratio, being an excellent example.

One consideration when investing for young investors is how it will be accomplished, or how the young investor will accumulate investable funds. Mutual funds have minimums for initial and subsequent investments in the fund, as detailed in Table 2. Some funds lower the initial investment minimum for uniform gift to minors act accounts (UGMA) or uniform transfers to minors act accounts (UTMA). And some funds will lower initial investment minimums if you agree to a minimum automatic transfer into the fund from a money market

fund account. These are changeable, so be sure to call the fund if the minimums are important.

The Web addresses of these funds are useful for an overview of the fund and how to invest. But, if you want some additional help with educating young investors, there are some useful Web sites in the accompanying box that are either devoted entirely to kids or have sections for young investors.

Take the time to get young people interested in investing at an early age. Get them educated early and investing early.

Can you think of a more practical, rewarding and lasting gift to the young? ♦

Educational Sites on the Internet

AAll.com

www.aall.com

Older children can benefit from the Education Area, which includes a glossary of terms, investing FAQs, and financial calculators. Investing Pathways explain the basics of investing in step-by-step lessons. Interactive tools include a portfolio tracking area where the progress of chosen stocks can be followed.

The Investor's Clearinghouse

www.investoreducation.org

Sponsored by the Alliance for Investor Education, the site is a collection of links to informative and educational documents and Web sites.

Jump\$tart Coalition for Personal Financial Literacy

www.jumpstartcoalition.org

This site provides a questionnaire for children to evaluate their level of financial knowledge.

National Center for Financial Education

www.ncfe.org

The Children & Money section contains articles on learning the value of money and improving spending practices. Books geared toward educating children about money are offered for purchase.

Strongkids.com

www.strongkids.com

Educational tools for children include financial calculators; an investment dictionary; the basics of mutual funds, stocks, and bonds; and ideas for making and saving money.

Treasury's Page for Kids

www.ustreas.gov/kids

The U.S. Department of the Treasury provides links to its comprehensive educational information including: a virtual tour of the Treasury, explanations of department functions, the banking system, and the history of currency and taxes. One area takes children through the process of setting up a business, paying taxes, and filing reports.

YoungBiz.com

www.youngbiz.com

This site provides teen-oriented message boards, market updates, quotes, and stock portfolios. Articles, profiles, and interviews with entrepreneurs are geared toward teaching teenagers financial decision-making skills.

Young Investor

www.younginvestor.com

Features include a game room with puzzles and a stock market simulation, an area where kids can share experiences, a library with articles and an investment dictionary, a college calculator, and a parents area.