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Stock Funds by Investment Objective and Style

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What is an investment objective?

There are many ways to try to make money from investments. An investor might take on additional risk to try to profit from potential growth in the value of the shares of a stock. A retiree might prefer an investment whose chief benefit is the periodic income payments it offers. Someone else's priority might be to preserve the value of the original investment, even if that means the investment doesn't increase much in value over time.

Like all mutual funds, stock funds are managed based on a specific investment objective. That objective will determine the role a specific fund will play in your portfolio, and how well it might fit with your overall investing strategy. The investment objective determines what types of stocks the fund's manager may decide to purchase. A fund may be broadly based, investing in both large- and small-cap companies in many different industries. Or it may have a much narrower focus, concentrating only on blue chips, for example, or stocks in a single industry.

Typically, a stock mutual fund's objective will be either capital appreciation, income from equities, or both. For example, a stock fund might have both growth and income as objectives, or its primary objective might be capital appreciation, with income as a secondary objective.

A mutual fund's investment objective is not necessarily the same thing as its investing style, though the two may overlap. In addition to pursuing a fund's investment objective, a fund manager may adhere to a particular investing style. For example, a growth fund focuses on stocks that are growing quickly and that seem to have greater than average potential for appreciation in share price. By contrast, a value-oriented fund buys stocks that appear to be undervalued by the market relative to the company's intrinsic worth. Each may have growth as its investment objective, but they pursue growth in different ways. Some managers even blend the two approaches.

Like most mutual funds, a stock fund may be either passively managed, as an index fund is, or actively managed. It also may be an open-end or closed-end fund .

Many mutual funds combine an investment objective with a specific category of stocks. For example, a fund might be an international fund whose objective is growth, or a growth fund that specializes in small-cap stocks. Here are some common stock fund types based on their investment objectives:

Caution: *Before investing in any mutual fund, carefully consider its investment objectives, risks, fees, and expenses, which can be found in the prospectus available from the fund. Read it carefully before investing. All investing involves risk, including the potenial loss of principal, and there can be no guarantee that any investing strategy will be successful.*

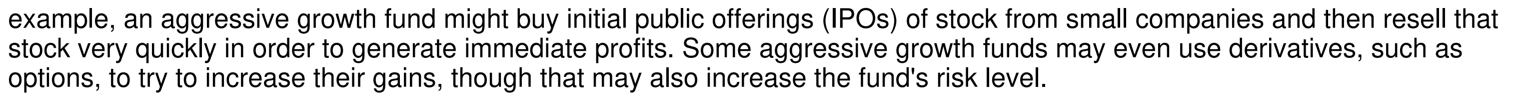
Growth fund

A growth fund's primary objective is capital appreciation over the medium to long term. These funds may invest in both well-established companies with above average growth potential and/or in fast-growing industries such as technology and health care. Investors in growth funds often are willing to pay a high share price because they expect future earnings to be much higher than current earnings. Growth companies often reinvest earnings in their businesses in order to continue to grow; therefore, they may pay only minimal dividends, if they pay dividends at all. As a result, growth funds may be more volatile than, for example, stock funds that focus on dividends from long-established companies in mature industries.

The risk with growth investments, of course, is the possibility of overpaying for future growth that may never materialize. Investing in a growth mutual fund allows you to spread your investment over many different companies. Though diversification alone can't guarantee a profit or protect against the possibility of loss, a disappointing performance by one company may be offset by the better performance of another. However, the tradeoff is that strong returns from one company can be diluted by weaker results from another. Some growth funds attempt to address that problem by limiting the number of companies in the fund.

Aggressive growth fund

To paraphrase an old saying, an aggressive growth fund is like a growth fund, only more so. Often known as capital appreciation funds, aggressive growth funds tend to take greater risk in pursuit of potentially higher returns than ordinary growth funds. For



example, an aggressive growth fund might buy initial public offerings (IPOs) of stock from small companies and then resell that stock very quickly in order to generate immediate profits. Some aggressive growth funds may even use derivatives, such as options, to try to increase their gains, though that may also increase the fund's risk level.

Typical investments for an aggressive growth fund include stocks of start-ups, small companies, and companies in new industries or that have innovative technology or products. Such companies do not normally pay dividends, and returns are derived almost exclusively from capital appreciation, or growth in share value.

Aggressive growth funds have the potential to turbo charge a portfolio, especially when the market is going up. However, the companies in which they invest have a high failure rate and also are normally the ones hardest hit in bear markets. An aggressive growth investor should be prepared to have a relatively long time horizon or a high tolerance for volatile returns--preferably both. However, since much of the return on an aggressive growth fund would come from selling shares at a profit, capital appreciation returns would be taxed at the (ordinarily lower) capital gains rate rather than as ordinary income.

In addition to their greater volatility, aggressive growth funds involve several tradeoffs. They often have a relatively high expense ratio relative to other types of funds, because the cost of frequent trading and research on smaller companies can mount up. Also, because an aggressive growth fund may trade frequently, that buying and selling can generate capital gains and losses that are passed back to the fund's shareholders, who may then owe capital gains taxes even if they haven't sold any of their fund shares. As with any mutual fund, the individual shareholder has no control over how and when those capital gains are realized.

Value fund

As indicated above, a value fund invests in companies whose stock the manager feels has become undervalued because it is experiencing legal or management difficulties, is in an industry that's out of favor with the broader investment community, or has not yet been discovered or fully understood. The assumption is that the company will not remain undervalued indefinitely, and that the fund will make money by buying shares before the anticipated upturn--which of course may take longer than expected or may never happen at all.

Value funds typically invest in companies that exhibit certain fundamental characteristics, such as a stock price that's low relative to the company's assets, earnings, or cash flow; products or services that give the company a competitive edge; a quality balance sheet that demonstrates sound financials; high or increasing insider ownership; and strong, forward-thinking management.

A value fund's primary objective is long-term growth; some also may produce current income from dividends.

Equity-income/growth and income funds

Though they may seem like a hybrid category, both growth and income funds and equity-income funds are actually types of stock funds. An equity-income fund focuses primarily on income from equity--that is, dividends from common, preferred, and/or convertible stock rather than bonds. To pursue that income, an equity-income fund tends to invest in stocks of companies that have a history of regular dividend payments; often, these are large companies that are fairly well established, that may be proven industry leaders, or that have long records of positive earnings. For example, so-called blue-chip stocks are prime candidates for an equity-income fund. Though a fund may also consider a stock's potential for capital appreciation, the pursuit of income tends to be paramount.

A growth and income fund, as the name implies, strives for both growth and income. It may do so by investing in stocks that pay substantial dividends but that also are considered growth companies. Or it may combine growth stocks with other stocks whose primary attraction is the dividends they pay.

Because income is a key part of such funds' objective and can help counteract the volatility of stock values, both categories are generally considered less aggressive than a growth fund.

To schedule an appointment with Faye Sykes, click here .

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