

**A
PROFESSIONAL SERVICE
FOR
INVESTORS**



NATIONAL ASSOCIATION OF INVESTMENT COMPANIES

61 Broadway, New York 6, N. Y.

No. 1 in a series on

**THE
INVESTMENT COMPANY**

... what it is

... what it does

... how it works

INVESTMENT companies are investors' co-operatives. They exist because the successful investment of money requires training and experience comparable to that required in any other profession — and is a full-time occupation in itself.

Most people have to learn this fact through a hard and expensive process. Individuals who wouldn't dream of trying to act as their own doctors or lawyers don't hesitate to undertake the investment of their carefully accumulated savings without either adequate training or competent outside assistance.

The vast majority of these individuals fail, sooner or later. Their capital is eaten away by successive losses on individual ventures; income declines. The only thing that varies is the length of time it takes.

SUCCESSFUL INVESTING

No one has found a sure road to riches through investment in securities. And everybody at times makes mistakes. But successful investment—which primarily means long-term preservation of purchasing power and the production of income — has been found to have two all-important foundations. These are:

1. *Diversification*, which means spreading one's risks over a sufficient number of different enterprises so that unexpected but inevitable misfortunes will not cause total loss; and
2. *Continuous supervision*, which includes careful investigation before buying and subsequent constant attention to the developments affecting an industry or company.

Investors with a great deal of money have been able to follow these two basic principles — and have long done so. But for the individual investor

of small or moderate means, they have been difficult, if not impossible, in application.

It is precisely to make these advantages available to all investors, regardless of how much money they have, that investment companies have been formed. *In its simplest terms, an investment company is a group of investors who have pooled their funds in order to obtain greater diversification than is possible for them individually and so they can afford to hire competent managers to spend their full time selecting and supervising their investments.*

In actual practice, the pooling of the funds of many individual investors is accomplished by setting up a corporation or its equivalent. Investors who want to obtain the services of diversification and continuous supervision provided by an investment company do so by purchasing shares of stock in the company.

SETTING UP A TYPICAL COMPANY

A share of stock represents ownership in a business. Thus, when you buy shares in an investment company, you are buying ownership of a part of the assets of that company. You and all the other people who have also bought its shares are the owners of the company.

To illustrate how this works, we will set up a hypothetical investment company and assume that you are one of the investors who purchase its shares. (Not all investment companies are set up in exactly the same way. The following description, however, is typical of a great many companies.)

You have, let us say, \$5,000 which you want wisely invested and carefully supervised. The investment company has set \$25.00 as the original price of the shares. Therefore you buy 200 shares.

At the same time, many other investors are doing the same thing, so that when the company is ready to start investing the money obtained from you and the other investors, it has a fund of \$10,000,000 altogether, and 400,000 shares have been issued, at \$25.00 each.

The company then proceeds to invest the \$10,000,000 which it has raised. Existing invest-

ment companies follow varying investment policies and the actual securities bought will depend upon the particular policy the company has determined to follow. Our hypothetical company, however, is to be a broadly diversified common stock fund; consequently the management starts off by investing substantially all of the \$10,000,000 in a list of common stocks which it believes are favorably situated.

Like many actual investment companies, our hypothetical company has a fixed policy of investing no more than 5% of total assets in any single security, but in all probability it will diversify among far more than the 20 issues which would be called for by such a policy. It will be certain, too, to buy securities representing a wide number of different industries and businesses.

THE INVESTMENT COMPANY'S INVESTMENTS

The list of securities which an investment company holds is called its "portfolio". Our hypothetical company's portfolio will probably include many of such well-known stocks as:

CHESAPEAKE & OHIO RAILWAY
CHRYSLER CORPORATION
DEERE & COMPANY
GOODYEAR TIRE & RUBBER
DU PONT
GENERAL ELECTRIC
GENERAL MOTORS
GULF OIL
INTERNATIONAL HARVESTER
INTERNATIONAL NICKEL
KENNECOTT COPPER
MONTGOMERY WARD
PARAMOUNT PICTURES
SEARS, ROEBUCK
SOCONY-VACUUM OIL
STANDARD OIL (NEW JERSEY)
TEXAS COMPANY
UNION CARBIDE & CARBON
UNITED STATES RUBBER
WESTINGHOUSE ELECTRIC

In addition, it will probably also hold stocks of some companies that you may never have heard of, because their products are not yet well known to the public. But investments in such companies very often turn out to be much more profitable to investors than those in old, well-established companies that everybody knows about.

This portfolio, of course, will be changed from time to time. The management will be continuously watching earnings trends and business developments affecting securities already held and securities not yet bought. Changes will be made when they appear advisable. At certain times, a portion of the fund may be held in cash or in U. S. Government securities.

The value of your ownership in the company will fluctuate from day to day, after the company has invested the money, just as would happen if you invested the money yourself. It can go up or down. In either event, you share the company's gains or its losses, in proportion to your interest, equally with every other stockholder.

INVESTMENT SERVICE FOR THE LONG-TERM

While these mechanics of an investment company are, of course, somewhat similar to those of any other kind of corporation, all you have really done is to pool your investment funds with those of many other people in order to obtain wide diversification and continuous professional supervision. You can ignore the day-to-day fluctuations in value of your shares, realizing that your need for the type of service you have obtained is a long-term one and that you have no need to make the frequent decisions which face investors who buy securities directly, instead of through an investment company.

To illustrate how you will be able to know the current value of your investment fund, let us suppose that after a period of time the securities owned by our hypothetical company have gone up in price to a point where, instead of the \$10,000,000 with which the company started off, the value of the

entire fund is \$12,000,000. All of this belongs to the investors who bought the 400,000 shares of stock. Each of these shares, accordingly, is now worth \$30.00 (\$12,000,000 divided by 400,000) instead of the \$25.00 a share paid in.

This figure is known as the "asset value per share" of the stock. It is published by companies at frequent intervals, and you can determine the total value of your own share of the company simply by multiplying the "asset value per share" by the number of shares you own. Your 200 shares, for which you paid \$5,000, are now worth \$6,000. But if, instead of rising in price, the securities the company held had gone down, each share would be worth less than the \$25 paid in and your 200 shares would be worth less than \$5,000.

"CLOSED-END" COMPANIES AND "OPEN-END" COMPANIES

So far we have assumed that everyone who wanted to buy shares of our hypothetical company did so before the company invested any of the money, and that they all paid the same price. Some investment companies have done this; anyone who wants to buy their shares later on, does so by purchasing them from someone already holding them. These are called "closed-end" companies.

In other cases, the company itself continuously creates new shares which can be purchased at any time by investors wanting to obtain the services of that company. Companies of this type are called "open-end" companies. Investors who come in after the company has started to invest pay a price which is based upon the value of the fund at the time they buy their shares; in other words, the "asset value per share". In this way, both old and new shareholders are treated fairly.

DIVIDENDS

As an owner of our hypothetical investment company, you are also entitled to your proportionate share of the income received on the investments

made, in the form of dividends, which are usually paid quarterly though sometimes at less frequent intervals. After deducting the costs of operating the company, the company's management divides all of the income which has been received by the number of shares of stock that have been issued to determine the amount that can be paid on each share. Some companies pay out the exact figure; others pay quarterly dividends at a fairly regular rate and once a year pay out the excess, if any. Many companies also pay what are known as "capital gains dividends". These are very different from dividends paid out of investment income and a separate pamphlet is devoted to their significance.

REPORTS

In order that you will know what your company has been doing, what its current portfolio holdings are, how much income has been obtained, and what the value of your shares is, full reports will be sent to you at regular intervals — probably every three months, but not less than twice a year.

INVESTMENT MANAGEMENT AND OPERATING PROVISIONS

The operation of an investment company naturally requires a number of people, first to do the very important job of investment management, and also to handle the physical details of keeping records, preparing reports for shareholders, attending to legal details, and the like. Different companies handle these problems in somewhat different ways. Our hypothetical company, typical of many actual companies, operates in the following way:

Administrative officers: There are a president, vice-president, secretary and treasurer. The president and vice-president, who started the company and like other investment company managers have had years of previous experience in the field of investing, are also directors of the company. There are three additional directors who have no other connection with the company, but were chosen be-

cause of their standing in the financial or business world. The Board of Directors is in direct charge of all affairs of the company, but in respect to the actual portfolio management it relies heavily upon the

Management Company: This is a separate company which, in return for a fee based upon the size of the investment company, provides all necessary management facilities and investment advice. It maintains a research department whose full-time job it is to study carefully all developments affecting the prices of securities and make recommendations to the Directors as to desirable portfolio holdings or changes.

Custodian: This is a large and well-known bank; it has physical possession of all the assets of the investment company — that is, its cash and securities certificates. If the company should sell, for example, 100 shares of General Motors stock, the Custodian would deliver the stock to the broker and receive the cash for it, which would be deposited to the company's account.

GOVERNMENT REGULATION

All investment companies are carefully regulated by the government. There is a national law, the Investment Company Act of 1940, which was designed to insure that only responsible people would start investment companies; that a company would not change its investment policy without approval by its shareholders; and that in the conduct of its affairs, sound fiduciary standards would be followed. The Act is administered by the Securities and Exchange Commission. All publicly owned investment companies are now registered with that body and are subject to its jurisdiction.

Nearly 1,000,000 individual investors do all or part of their investing through the investment company medium, and their joint ownership in the 118 investment companies which are members of the National Association of Investment Companies is close to \$2,000,000,000.

THE INVESTMENT COMPANY

This is the first of a series of pamphlets describing various aspects of the investment company. Pamphlets available or in preparation include those listed below. Single copies can be obtained without charge from the National Association of Investment Companies, 61 Broadway, New York 6, New York. Larger quantities are available at a nominal price.

- I. A Professional Service for Investors
- II. Do You Need the Services Investment Companies Provide?
- III. How One Basic Service Fits Varying Investor Needs
- IV. How Investment Company Shares are Bought and Sold
- V. Has the Service Proved its Worth?
- VI. Government Regulation — Its Meaning to the Investor
- VII. Taxation — Its Effect on Your Dividends
- VIII. Common Stock Funds
- IX. Balanced Funds
- X. Bond and Preferred Stock Funds
- XI. Specialty Funds
- XII. Leverage Stocks
- XIII. Senior Securities
- XIV. How to Compute Investment Company Performance
- XV. How to Compute Your Own Performance