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Chapter 19: Bonds and Mutual Funds

Check Your Answers: Section Assessment

Section 4

Review Key Concepts

1. Newspapers, quotations, prospectuses, annual reports, financial publications, professional advice, the Internet.

2. When you buy shares in an open-end mutual fund from an investment company, you have several purchase options: a regular account transaction, a voluntary savings plan, a payroll deduction plan, a contractual savings plan, or a reinvestment plan. You can also sell shares of closed-end funds to another investor any time you want on the stock exchange or in the over-the-counter market. Shares in an open-end fund can be sold to the investment company that sponsors the fund.

3. Income dividends are reported along with all other dividend amounts you have received; they are taxed as regular income. Capital gain distributions are reported on your federal income tax return. Capital gains or losses that result from your selling shares in a mutual fund are reported on your federal income tax return. Almost all investment companies allow you to reinvest the capital gains distributions and income dividends you earn instead of receiving cash. These distributions are taxable and must be reported on your income tax return. Since you get to decide when to sell your stocks or bonds, you can pick the tax year when you pay tax or deduct losses on these investments. Mutual funds buy and sell securities on a regular basis during any 12-month period, so you have no control over when the mutual fund sells securities.

4. Capital gain distributions are payments made to shareholders that result from the sale of securities in the fund's portfolio. A capital gain distribution occurs when the fund sells securities within the fund's portfolio and distributes profits to shareholders. A capital gain occurs when the shareholder sells some of his or her shares in the mutual fund.

Higher Order Thinking

5. Mutual funds can be used to invest money that is contributed to tax-deferred 401(k) and 403(b) plans or individual retirement accounts (IRAs). These investments will grow larger over time, so the earlier you start, the longer it is allowed to grow.

21st Century Skills

6. Make Judgments and Decisions A voluntary savings plan would allow Erik to make smaller purchases than the minimum required by the regular account transaction, but he must commit to making regular minimum purchases of the fund's shares. A contractual savings requires that Erik make regular purchases of shares over a specific period of time, and pay penalty fees if he does not make the required purchases. With a reinvestment plan, Erik’s distributions would be automatically reinvested to buy additional shares of the fund without paying additional sales charges or commissions. Students’ suggestions will vary, but most will likely suggest that Erik choose the voluntary or reinvestment plan because the contractual plan is too risky.

Mathematics

7. Capital Gain and Percentage of Asset Growth Withdrawal Total capital gain after one year = ($46.25 - $43.50) × 125 shares = $343.75; Withdrawal amount after one year = $343.75 × 45% = $154.69; Capital gain per share after two years = $52.90 - $43.50 = $9.40