WealthCE

Open & Closed Funds

Mutual funds come in two accessibility categories: open and closed. Open end funds are entered and exited directly though the mutual fund itself. The mutual fund continuously sells shares to purchasing investors. If investors want to exit, they sell the shares they bought directly to the fund. These fund categories are extremely common, covering the vast majority of mutual funds available on the market. Part of the reason for their popularity is their easy accessibility. These funds issue unlimited shares to meet demand, supply is never an issue. It also is never a factor on share price: Open ended funds always sell their shares at their Net Asset Value. Your purchase of shares from an open ended fund increases the fund's size by your investment after the front end loads are deducted. When exiting the fund, you will sell your shares back to the fund itself for the current Net Asset Value minus back end load fees. This usually comes from the cash redemption pool. If the manager does not have cash available, they will be forced to liquidate investments to acquire the currency to pay you.

Since all purchases into a fund occur at the Net Asset Value per Share, front end loads make all buy-ins at NAV constantly overvalued. Back end loads always reduce your withdrawals, increasing your losses or erasing parts of your gains. Your open end fund's return needs to exceed the costs of the loads, annual operating expenses, and 12b-1 fees. You need to select funds which will provide the performance to cancel these costs. This is especially important with open end funds whose issue and redemption price is equal to net asset value.

Closed end funds are not purchased or sold from the fund itself. These funds trade on share exchanges, so the fund managers do not have to issue or redeem shares on a regular basis. They issue shares at the beginning of the fund via an initial public offering. Once the initial desired amount of shares have been sold to the first investors, the fund managers use the finances raised to purchase the fund's investment instruments. After this point the shares are traded openly between investors, and the fund managers will not sell additional shares. Management will only redeem shares if the fund is dissolving by selling all assets and distributing proceeds to all investors holding shares at the time. Investors who want to exit the firm must sell their shares on the open market.

Closed funds have drastically different dynamics compared to open funds. Close end funds don't trade at their net asset value. They trade based on supply and demand. If they are in high demand they will trade at a premium to their value, if in low demand they will trade at a discount. Closed end funds rarely trade exactly at their net asset value. This also adjusts the way you receive your return: Increases in NAV will not determine your profit since the fund's price is tied to demand. Returns must be accompanied with increased demand to be profitable. With an open end fund, the increase in net asset value alone determines your return. To increase returns buying funds at a discount to NAV is preferable if possible, but you must be aware of the reason for its pricing. If the discount disappears and the fund returns to net asset value, you have already gained the difference as profit.