

Investment BRIEF

An Overview of Collective Investment Trusts Investing in Mutual Funds

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This investment brief presents an overview of First Mercantile's collective investment trusts investing in mutual funds.

What is a collective investment trust investing in a mutual fund?

A collective investment trust is a trust fund sponsored by a bank or trust company (i.e. First Mercantile Trust Company) that pools the contributions of participants of qualified retirement plans and purchases shares of one or more mutual funds that represent the investment objective for which the participant is investing. It is not a security in which the general public can invest, only participants of qualified retirement plans. The collective investment fund also holds a small percentage in a money market mutual fund for liquidity to facilitate transfers for participants who wish to buy or sell on any given business day without facing the delays associated with actual mutual fund transactions and for the payment of fund-related fees and expenses.

Why does the unit value of the collective investment trust investing in a mutual fund differ from the net asset value (NAV) of the actual mutual fund?

Because the collective investment trust is a totally-separate fund that holds both the primary mutual fund and a small percentage in a money market fund, First Mercantile establishes an initial unit value independent of the NAV of the mutual fund in which it invests, usually \$10.00 per unit. As the price of the primary underlying mutual fund fluctuates, as measured by its NAV, so will the unit value of the collective investment trust. However, these two will not move together on a dollar-for-dollar basis. For example, if the NAV of the primary underlying mutual fund

increases by 5%, the unit value of the collective investment trust in which the mutual fund is held should increase by nearly the same percentage. The percentage change in the NAV of the primary mutual fund and the unit value of the collective investment trust may differ slightly due to the small amount within the collective investment trust that is invested in a money market fund along with the effect of custodial or recordkeeping fees.

How does the market value of a participant's holdings in the collective investment trust compare to the market value in a traditional mutual fund?

The market value of a participant's balance in a collective investment trust is calculated by multiplying the number of units the participant holds in the collective investment trust by the unit value of the collective investment trust. Here's how this process works:

Assume a participant with \$2,000 in the ABC company retirement plan desires to invest in XYZ Mutual Fund at an NAV of \$20 per share. The participant's investment would produce the following:

Market Value	NAV	#Shares
\$2,000	\$20	100

Under the collective investment trust with an initial value of \$10 per unit, the same participant with \$2,000 to invest will receive 200 units of the collective investment trust as indicated below:

Market Value	Unit Value	#Units
\$2,000	\$10	200

This example serves to illustrate that when a mutual fund is converted to a collective investment trust, each participant's overall market value is not affected.

How is the unit value calculated?

The collective investment trust is valued daily based on the market value the custodian provides for all assets held in the collective investment trust at the end of the trading day less accrued fees and expenses and then divided by the total number of units investing in the collective investment trust to arrive at the unit value. Unit values are updated each business day to reflect the prior day's activity.

Will the return on the collective investment trust differ from the return on the underlying mutual fund?

Because the collective investment trust holds a small percentage in cash equivalents (i.e. a money market mutual fund) and because buys and sells of the primary underlying mutual fund are made at various times, the return for the collective investment trust may differ slightly from the total return of the primary mutual fund held within the collective investment trust. Efforts are made to minimize potential differences between the return of the collective investment trust and the return of the primary underlying mutual fund.

When the price of the primary mutual fund held in the collective investment trust is appreciating, the return of the collective investment trust should slightly trail the actual performance of the primary mutual fund. However, when the price of the primary mutual fund held in the collective investment trust declines, the performance of the collective investment trust should slightly outperform the actual performance of the primary mutual fund. The reason for this slight variation is the "cash drag" associated with the small cash equivalent position in the

collective investment trust, which tends to hinder performance when the primary mutual fund is appreciating but tends to help performance when the primary mutual fund is depreciating. Money Market instruments generally maintain a stable principal value that creates the drag in an uptrending investment market and a stabilizing effect in a downtrending investment market.

How much cash equivalents does a collective investment trust hold?

The amount of cash equivalents varies from time-to-time based on the amount of liquidity required to facilitate participant transfers on a daily basis and the payment of trust fees and expenses. Typically, cash equivalents represent 5% or less of the total market value of the collective investment trust. Efforts are made to minimize the amount of cash equivalents held in the trust while still allowing the trust to handle daily transfers.

My mutual fund pays a capital gain distribution or a dividend. What happens to this income?

Capital gain distributions and dividend income are, upon payment, received by the collective investment trust and automatically reinvested in additional shares of the primary mutual fund or funds within the collective investment trust. The collective investment trust itself does not pay a dividend. However, the market value of all capital gain distributions and dividends are reflected in the daily unit value calculation of the collective investment trust.

How many shares of the mutual fund do I hold?

Individual participants in the collective investment trust do not hold actual title to shares of the mutual fund or funds in which the collective investment trust invests. Instead, participants hold "units of

participation” in the collective investment trust that in turn holds legal title in trust to the shares of the mutual fund for the benefit of investing plan participants.

What about fees?

Returns of the collective investment trust are affected by fees, including a fee to First Mercantile for investment oversight and other trustee duties (referred to as the Fund Trustee Fee), the internal expenses of the underlying mutual fund or funds and other expenses associated with the operation of the trust. Please see the prospectus of the mutual fund or funds for a description of their internal fees and expenses. First Mercantile does not control the internal fees and expenses of any mutual fund. First Mercantile may, however, receive 12b-1 fees, sub-transfer agency fees and/or other similar fees from some of the mutual

funds or their distributors for services rendered to the mutual fund through the collective investment trust for the benefit of the participant investors. In these instances, First Mercantile reduces its Fund Trustee Fee by the amount of fees that it actually receives. Amounts that First Mercantile receives from the mutual funds in which the collective investment trusts invest are available upon request.

Expenses other than the Fund Trustee Fee that are charged directly against the collective investment trust include audit, custodial, legal, brokerage and trading fees. These expenses are in addition to the Plan Servicing Fees (covering recordkeeping and investment consultant fees), the Fund Trustee Fee, and the internal fees and expenses of the mutual fund or funds in which the collective investment trust invests.