VIGIL Strategies
Taking you where you want to be
First Quarter Newsletter 2004

Mutual Fund Mayhem And What to Do About It

For a variety of reasons mutual funds have become the investment vehicle of choice for many investors. Certainly the heavy promotion by mutual fund companies who realize significant profits on this easy investment offering has lured many investors. Likewise, mutual fund popularity has been aided by salespeople "advisors" who, highly compensated for pushing a limited number of mutual funds and annuities, claim that mutual funds or annuities are the panacea for every investment issue. Lastly, mutual fund popularity can also be attributed to the false sense of security that investors get by thinking that appropriate "due diligence" simply means looking at the historical performance of the fund while paying scant attention to the index against which that performance is compared and paying even less attention to the important information contained in the fund prospectus.

The collective consequence of the above is that mutual funds (like annuities) are over-prescribed and over-used as investment solutions. Penicillin is a fine drug for certain things, but it is of no benefit to you if you have a cold. And while mutual funds are good solutions for certain situations, they aren't the answer for every, or even most, investment challenges. Unfortunately many investors have been doing the investment equivalent of "taking penicillin for their cold" by inappropriately relying on mutual funds as their investment vehicle of choice.

Scandals

Then against this backdrop of over-prescription and over-use comes news that rocks the confidence of investors in their mutual fund investments. First are the late trading and insider trading scandals. Here authorities used information available to investment professionals and individual investors alike to detect funds that should be investigated. So, proper attention to detail and complete due diligence should unearth these concerns and cause the careful investor to steer clear. However, since this information is not disclosed in even a complete reading of the fund's prospectus, and most investment advisors are either unaware of the tools needed to perform due diligence or they ignore the tools (because such negative information gets in the way of making a sale) investors are still left vulnerable to shaky investments.

New Focus on Disclosed Practices

More recently, attention has been focused on practices that are actually addressed in a prospectus but which have never been fully examined or completely understood. For example, many investors have recently received letters advising them that their brokerage firm may have improperly applied or failed to apply commission breakpoints on their purchase of "front load" mutual funds, resulting in the brokerage firm receiving more compensation than they were entitled to receive. Unfortunately, to begin with, many investors were not even aware that they were subjected to this front load charge – an immediate reduction in the value of their investment – let alone that it may have been improperly charged. And the brokerage firms – who have a complete record of account history somewhere in their archives and who have the exact knowledge as to what should and should not have been charged – are requiring investors to dig back through records to come up with the information as to transactions in which the brokerage firm may have assessed an improper charge. So let me get this straight – the *brokerage firm* made a "mistake", but the *investor* is supposed to dig back through everything to document the mistake or the brokerage firm is going to keep the money that they improperly charged! Now *there's* a practice that someone in authority ought to do something about!

Of great interest to us has been the recent attention to common practices that mutual funds have used to gain distribution, but which have increased "hidden" costs to investors – i.e., those costs that are netted against investment returns before the fund's return is reported to investors. These costs are actually being paid by fund investors

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(they reduce the reported return), but because they are "buried" in the return figure that is reported, you don't really know they are there unless you read the prospectus and understand what it is telling you about these costs. For example, there are large fees that many brokerage firms (including Schwab, Waterhouse and Fidelity to name a few) and some trust companies receive from so-called "no-load" mutual funds (i.e., presumably "no commission" funds) in order to be on the brokerage firm's or trust company's "recommended list" of funds to their clients. These fees, paid out of the investors' investment and thereby reducing their return, serve no purpose other than to influence the funds that will be presented as viable options to clients. Another example is the practice of a mutual fund directing its securities trades through a particular brokerage firm at very favorable commission rates for the broker in exchange for the broker "recommending" particular the mutual fund to its clients.

While these kinds of practices are fully disclosed in the fund prospectus they result in significant – and in our view unnecessary - costs that substantially decrease realized investment returns. The careful investor would avoid funds that involve these kinds of costs because there are other, equally good funds that do not have these costs. In fact, many investors are surprised to learn that often a different class *of the very same fund* is available without these costs! All too often the investor's own due diligence is not complete enough to achieve a full understanding of these expenses, and investors they end up relying upon the advice of an "advisor" who economically benefits in some manner from the existence of these expenses and who is therefore reticent to bring them – and their impact on investor returns - to light.

Have We Really Come to This?

In a recent conversation about the problems mutual fund companies and the brokerage firms who distribute their funds are facing, a respected member of the brokerage industry stated "Everyone is having these problems," as if to say that we should ignore these issues because they are so pervasive. Words my mother used to say to me – "Just because your brother goes and jumps off a cliff doesn't mean you have to do that, too" – seem to be hauntingly applicable here. The fact that there are investment alternatives that could and should be used in many cases where mutual funds are being used, coupled with the fact that there are mutual funds and mutual fund share classes not plagued by these problems, indicate to me that we do not have to "jump off the cliff, too" with poor mutual fund investment choices. The problem is NOT a lack of availability of quality investment products. Rather, the problem is a combination of inadequate or unenlightened due diligence and investors' reliance upon the advice of "advisors" with conflicts of interest in their advice that is not fully understood or whose impact on the ultimate recommendations are not fully appreciated.

What To Do?

What you need to do depends upon whether you are going to tackle investment issues yourself or if you are going to try to rely on the advice of an advisory professional to guide you. If you are going to handle these things yourself (because that is "so easy to do" according to the popular media) than these issues should serve as a wake up call. You may need to consider many more things as part of your due diligence process than you may have been.

If you are going to rely on the advice of an advisory professional, it is admittedly hard to come up with an easily applicable "litmus test" to assure that the advice you receive is based entirely on your situation and your best interests and not tainted by the influence of benefits your advisor will receive by directing you in a certain direction. Selecting a fee-based or fee only advisor is a good start, but it is not complete enough because there are now many advisors who charge fees who also receive other compensation from advising clients and still have conflicts in their advice. However, after years of seeking such a litmus test, we think we have found one! Before you accept any advisor's advice, ask these questions:

1. ***Do you maintain any licenses as a securities broker?*** In order to sell you any investments or participate in any transaction-based revenue, an investment professional MUST be licensed as a securities broker. An advisor that does not possess such licenses cannot sell you anything! To stay away from advisors that are conflicted by their need to get you to buy what they have to sell instead of getting you what is best for you, stay away from advisors that possess any securities license.

2. ***Does your company or any of its affiliated companies act as an advisor to any mutual funds or receive compensation of any kind from any mutual fund?*** Companies who create their own mutual funds or who receive compensation from mutual funds for being on the company's "recommended list" have a financial incentive to limit their due diligence on investment options for you to these funds. There are many other – and more than likely, better – options for you out there.

If you want to rely on the advice of an advisor and your advisor doesn't pass these two tests, our advice to you – KEEP LOOKING! There are advisors out there that will pass both of these tests. Those that do will give you the best advice about whether you, in your situation, should be in mutual funds at all and if you should be, which mutual funds will be give you the best returns at reasonable costs. If you put due diligence into the selection of your advisor, you can more comfortably rely on their execution of due diligence on your behalf.

Using Your Inheritance as Investment Building Block

Inheriting a large sum of money may sound like the one good thing that comes out of an unhappy event. However, it is more of a mixed blessing than most people realize. There are taxes, complex financial decisions and considerations, and, often, questions from other family members. These complexities can add stress to an already stressful time and leave many people feeling overwhelmed. Yet, with careful thought and planning these challenges can be minimized.

Figuring out how to invest your inheritance is an important process. Regardless of its size, your inheritance may literally represent a once-in-a-lifetime opportunity to lay a solid financial foundation for both the near and distant future. If you find yourself in this situation consider speaking with an experienced independent fee-only Financial Advocate. Financial Advocates, like those at Vigil, are equipped to help you with the numerous issues involved in inheriting money, such as estates, trusts and taxes.

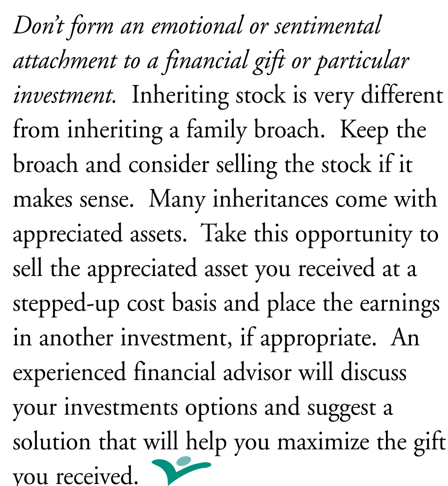
4 Suggestions for Making the Most Out of Your Inheritance

Don't make rash decisions. A study by Oppenheimer Funds found that 40% of baby boomers who received at least a $50,000 inheritance made a financial decision regarding that inheritance in less than one week. Don't make decisions out of fear to the first person who offers who financial assistance. Take time to grieve, gather facts, and prioritize.

Identify what your goals are. According to studies, 31% of people spend their inheritance on a home or remodeling, 30% on education, 10% on a vacation, 9% on a new car, 3% to help children or other family members, 2% to pay off debt and only 1% invest the money. If you would like to use your inheritance to lay a solid financial foundation make sure that you do so before this gift is spent on other items. While you don't want to make a hasty decision you also don't want to linger in indecision.

Get a professional opinion. Even if you decide to ultimately manage your inheritance gift on your own, a professional opinion can provide valuable insight. However, make sure the person you are seeking advice from is qualified. For example, if your financial advisor gives you legal advice about your inheritance make sure your advisor is licensed to practice law! You'd be surprised at the amount "advisors" who like to dole out legal, tax, and financial advice without the requisite education or qualifications. Make sure you are dealing with a professional-not a salesperson. If you are inclined to manage your gift on your own keep in mind that many fee-only financial advisors, like Vigil, offer a one-time consultation service that will create a "roadmap" to assist you on your financial journey.

Don't form an emotional or sentimental attachment to a financial gift or particular investment. Inheriting stock is very different from inheriting a family broach. Keep the broach and consider selling the stock if it makes sense. Many inheritances come with appreciated assets. Take this opportunity to sell the appreciated asset you received at a stepped-up cost basis and place the earnings in another investment, if appropriate. An experienced financial advisor will discuss your investments options and suggest a solution that will help you maximize the gift you received.

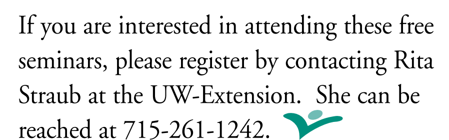


UW-Extension Requests Vigil's Assistance with Investment Curriculum

In an effort to help area residents best utilize their financial resources, the University of Wisconsin Cooperative Extension requested the assistance of Vigil Trust and Financial Advocacy in developing a curriculum designed to teach individuals investment basics. The result of this collaboration is a five week course entitled "Financial Security in Later Years" which will be offered, free of charge, every Monday in March at the UW -Extension offices located at 212 River Drive in Wausau. Classes will be held from 1-3 p.m. and from 7-9 p.m. with a different topic presented every week.

On Monday, March 15, Trust Officer and Financial Advocate, Anza D'Antonio, J.D., will discuss "What Makes a Good Investment." This discussion will cover considerations in evaluating: individual equity and fixed income investments, tax-deferred versus non-deferred accounts, scams and fraud. On Monday, March 29, Anza will present "Estate Planning Issues." This class covers the differences between Wills and Trusts and planning opportunities for Social Security and Medicare recipients. Anza will also discuss the advantages and disadvantages of long term care insurance.

If you are interested in attending these free seminars, please register by contacting Rita Straub at the UW-Extension. She can be reached at 715-261-1242.



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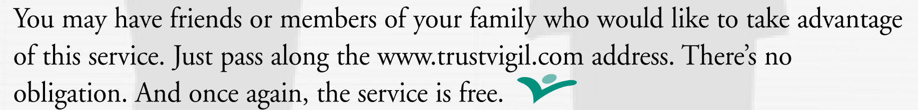
Answers to your financial questions from "The Money-Expert"

As a service to investors, Vigil has introduced a unique, free "Q&A" service. Best of all, you can ask questions 24 hours a day, seven days a week. Whenever a question comes to mind, just go to your computer and get on the Internet. You'll find the link to "The Money-Expert" at on the homepage of www.trustvigil.com under "Have a financial Question?" Jot down your questions and Tom Batterman—"The Money-Expert—will answer them promptly.

Most of the time, questions about investments and other financial matters pop into our minds and then are quickly forgotten. With "The Money-Expert" always available, you can send you questions whenever it's convenient.

You may have friends or members of your family who would like to take advantage of this service. Just pass along the www.trustvigil.com address. There's no obligation. And once again, the service is free.



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