Fisher Investments™

Five Pitfalls of Mutual Funds

Why You May Need a New Approach

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How Do Mutual Funds Work?

Mutual funds pool money from investors to invest in stocks, bonds, or other securities. Pooling assets can be a cost-effective way to diversify smaller portfolios, and most mutual funds allow their shareholders to buy and sell shares daily, making them highly liquid investments. Mutual funds can also provide access to professional money management services that might not otherwise be available to some individuals.

If you're like many investors, you've probably considered mutual funds for your retirement nest egg. But while mutual funds are appropriate for some investors, they might not be right for you.

Are Mutual Funds Right for You?

Mutual funds can be a good tool for investors with smaller portfolios seeking professional money management, especially young investors just starting out. Mutual funds can provide diversification that would otherwise be too difficult and costly for many investors to achieve.

For example, someone with $10,000 to invest could put it into a well-diversified mutual fund that owns 200 different stocks. It would be expensive and cumbersome for that same investor to purchase each of the 200 stocks individually. They would probably be able to buy only a few shares of each, incurring trading and other costs with each purchase. Even paying just $5 in commissions per trade at the deepest discount broker would cost $1,000, or 10% of the hypothetical portfolio, just to get started. Because mutual funds spread these costs out among many investors, smaller investors can generally gain access to more diversified portfolios at lower fees.

However, for investors with larger portfolios, mutual funds can become unnecessarily expensive and inefficient, making it more difficult to reach investment goals.

Fisher Investments assembled this guide to show you five reasons why there may be better options for larger investors. **If you're a high net worth investor with a portfolio of $500,000 or more, perhaps it's time to graduate to a better approach.**

Mutual Fund Pitfall #1: Diversification Gone Wrong

Generally, diversification benefits investors, which is one of the primary reasons people buy mutual funds. However, mutual funds can actually cause over-diversification.

Although it's the most common justification for owning mutual funds, **diversification**—if poorly implemented—can become detrimental.

Why? We've found many high net worth mutual fund investors hold between 5 and 10 mutual funds in an effort to diversify their portfolios. On average, **equity mutual funds** own about 220 stocks,[1] so owning 10 funds could mean having stakes in as many as 2,200 securities—or more. Exposure to so many stocks can make even matching the performance of the overall market difficult once fees are taken into account. Such a strategy may also result in an inadvertent over-concentration in certain sectors, styles, or specific stocks.

For example, two Fidelity mutual funds, Blue Chip Value and Blue Chip Growth, actually contain 66 of the *same holdings* resulting in over 30% of the Blue Chip Value Fund being held in the Blue Chip Growth Fund, and vice versa.[2] If, in an attempt to diversify and manage risk, a high net worth mutual fund investor owned both the value and the growth funds, the investor could actually be increasing risk.

Quick Notes

Diversification: A risk management technique that mixes a variety of investments within a portfolio to minimize the impact of any one security on overall portfolio performance.

Equity Mutual Funds: Mutual funds that hold only stocks.

Fund Manager: Person or people directing the investment strategy for a mutual fund.

Fidelity Blue Chip Value and Growth Mutual Funds

	Total Holdings	Unique Holdings	Unique %	Duplicate Holdings	Duplicate %
Blue Chip Value	154	88	57%	66	43%
Blue Chip Growth	219	153	70%	66	30%

Source: Morningstar, 3/30/2010.

[1, 2] *Morningstar, 3/30/2010.*

Moreover, the managers of different mutual funds within the same company don't communicate with one another about your overall portfolio. One **fund manager** may be buying a stock while another sells the same stock, causing you to pay two commissions for no net change in position. Why is the first manager doing the opposite of the second? Who's right?

How Is Fisher Investments Different?

Fisher Investments doesn't rely on mutual funds for diversification for its Private Client Group clients. Instead, we create a personalized global portfolio for you that may include individual stocks, bonds, or other securities, depending on your personal situation. As a high net worth investor who has worked hard to save, you've earned access to more individualized money management techniques than mutual funds typically offer.

Mutual Fund Pitfall #2: Lack of Personalization

Mutual fund managers don't know who you are and will likely never know your specific investing needs so their objective may not coincide with your goals. In addition, they don't offer the personalized service high net worth investors deserve.

Your investing strategy needs to be aligned with achieving your goals. While general goals like long-term growth or generating cash flow for living expenses are common to many investors, factors such as **time horizon**, allocation preferences, life expectancy, and income needs can vary widely from person to person.

But mutual funds tend to follow strict **mandates**, such as investing in a set portfolio allocation or in a specific **style**. Few mutual fund managers have the flexibility to change their asset allocation or style mandates significantly based on market conditions.

Just as importantly, most mutual fund managers won't adjust their strategies to reflect your changing goals and needs. For example, a 40-year-old seeking growth with no income needs likely has a very long time horizon. But a 60-year-old with assets saved to buy a vacation home in two years might have a very short time horizon.

The mutual fund manager won't know the difference, so the very important allocation choice falls to the investor, who may or may not be qualified to make that decision.

Quick Notes

Time Horizon: The length of time assets will remain invested.

Mandate: A set of guidelines outlined by a fund to be followed when investing. An example would include large-capitalization US growth stocks.

Style: A category of stock investment. Examples include growth, value, large-cap, and small-cap stocks.

With mutual funds, you're merely an anonymous member of the investing pool. For something as important as your financial future, flexibility and awareness of your situation are musts. Mutual funds offer neither.

Because of this inflexibility, mutual fund investors often purchase several funds, hoping to meet their specific needs. Or they pay for an *additional* adviser to select mutual funds for them. Even with assistance, it's unlikely a portfolio loaded with various mutual funds will turn out to be the most efficient strategy.

How Is Fisher Investments Different?

Unlike mutual fund managers, we get to know you personally, taking time to understand your financial situation and investment goals before recommending a portfolio strategy. We have lengthy and detailed discussions about your time horizon, life expectancy, growth objectives, and cash flow needs, which help ensure our plan for your portfolio is aligned with your needs. We regularly communicate with you about our market outlook and investment strategy in a variety of ways, including frequent discussions with your personal Investment Counselor, written communications, forecast seminars and small group discussions across the country, and client conference calls. Don't sell yourself short. Your assets deserve individual attention.

Our strategy is also driven by our market forecasts. As conditions and our outlook change, we can adjust your portfolio to capitalize on any new trends we see—we aren't tied to one single style or approach. Markets always evolve; investment strategies should evolve too.

Mutual funds can be convenient for smaller portfolios. But for a larger pool of assets ($500,000 or more), we can build a diversified portfolio of individual stocks, bonds, or other securities tailored to your specific investing needs.

Mutual Fund Pitfall #3: Hidden Fees, Heavy Costs

In the back of those meticulously crafted mutual fund informational pamphlets and brochures, the fine print often reveals complex fee structures incomprehensible to average investors. As a result, many people pay more in fees and expenses than they realize.

Mutual funds can be costly. Fees can stack up quickly and take a significant bite out of your returns—before taxes come into play. Even "no-load" funds, which might be free of initial sales or transaction charges, can charge numerous management and other fees that aren't obvious. These add up, often increasing the total cost by as much as one or two percentage points, and decreasing your net returns. A 1% fee difference may seem small, but it can have a dramatic impact on your portfolio over time. Consider this example:

Expense Example*

Amount Invested	For How Long	Annual Expenses	Avg. Annual Return	End Amount
$1,000,000	20 years	2.0%	10%	$4,660,957
$1,000,000	20 years	1.0%	10%	$5,604,411

**This example assumes a $1,000,000 portfolio with an annual return of 10%. The example is provided for illustrative purposes only, doesn't include transaction costs, and is not intended to portray any prior or future performance results. Actual returns will vary. Investments in securities involve the risk of loss.*

Wondering how much you're paying? Ask your mutual fund company or broker for a detailed description of all fees, or simply go to www.personalfund.com[3] to look up your fund's fee structure. Either way, you'll find mutual fund fees are assessed in a variety of ways.

Some fund managers charge a sales load, known as front-end or back-end sales load, charged when investors buy or sell shares. In addition, investors often pay a **management fee**. Other fees include sales, marketing, and service fees (**12b-1 fees**), and operating costs (all of which make up the expense ratio). Plus, funds with high **turnover** can mean more commissions, and the average world stock mutual fund has a 96%[4] annual turnover rate. Many investors will also pay fees to a financial adviser (known as wrap fees) *just to tell them which funds to buy*.

These layers quickly form a cloudy, burdensome fee structure—typically between 2% and 4.5% annually.[5]

Quick Notes

Management Fee: The fee mutual funds charge clients to manage their money.

12b-1 Fees: A fee charged to fund shareholders that covers marketing costs and sometimes shareholder services. The fee is charged as long as shares of the fund are held.

Turnover: The rate at which stocks in a portfolio are bought and sold.

[3] *Registration fee may apply. Fisher Investments is not affiliated with www.personalfund.com*
[4, 5] *Morningstar, 3/30/2010.*

How Is Fisher Investments Different?

Higher fees make it more difficult to achieve long-term goals. The fee structure of many mutual funds may not be completely transparent, making it difficult to know exactly how much you're paying.

Fisher Investments Private Client Group's clients know exactly what they're paying. There are no sales loads, no 12b-1 fees, no expense ratios, and no wrap fees. We charge only our management fee,[6] which is based solely on the amount of money we manage and aligns our incentives with our clients' best interests. Our portfolio turnover average is substantially lower than most equity mutual funds—about 15%-30% annually, on average, over time[7]—and we don't earn commissions on trades. Our fee structure is simple and transparent.

Fee Comparison

	Mutual Funds	Fisher Investments
Management Fee	Yes	Yes
Trading Commissions	Yes	Yes
Sales Load	Maybe	No [6]
12b-1 Fees	Maybe	No

You've worked hard to build your nest egg, and you should know you have a better option than costly mutual funds. Let us show you how our high-level, personalized service and investment management expertise can be the cost-effective approach you need.

[6] *Clients pay transaction charges directly to the custodian and/or broker-dealer.*

[7] *Annual turnover for Private Client Group Global Total Return Clients from 1995 to 2008 was typically between 15%-30% although this number can vary significantly from year to year.*

Mutual Fund Pitfall #4: Lack of Communication

Don't expect much in the way of communication or explanation from a mutual fund manager. Personal interaction and communication about strategy and portfolio changes are rare.

It's difficult enough for individual investors to stay apprised of what their mutual funds are doing, but it's even harder to get someone to explain *why* they're doing it. Mutual funds can have thousands upon thousands of shareholders, and personal communication is not a standard industry practice. When is the last time you heard of someone calling a mutual fund manager to ask why the fund is up or down or why a certain stock was bought or sold? Have you ever heard of a mutual fund manager calling an investor to see if their investment objectives have changed and to make sure the fund is still a good fit? Or to see how planned changes in the fund might impact an investor's tax situation?

How Is Fisher Investments Different?

Fisher Investments' clients are not simply "part of the pool." You get proactive service from a personal, dedicated Investment Counselor who will contact you as frequently as you'd like. Further, your Investment Counselor will reach out to you whenever important changes occur in your account and review your investment objectives with you on an ongoing basis. And you can contact your Investment Counselor at your convenience with questions about your account or about Fisher Investments' market outlook. It's a level of service you deserve as a high net worth investor, but simply won't get from most mutual fund managers.

We also offer many client programs to provide timely updates and education regarding individual portfolios and financial markets. One of our most popular, Fisher Forecast Seminars, is held in more than 60 cities nationwide. Designed and offered exclusively for our clients and their guests on a complimentary basis, the seminar provides access to senior decision makers.

Additionally, we distribute a number of written communications, including quarterly market reviews, email updates, a series of published books through Fisher Investments Press, and online materials to further investor education. We also encourage clients and prospects to visit our online magazine, www.MarketMinder.com, for current and often irreverent views on capital markets and the global economy.

Annual mutual fund prospectuses and generic letters to shareholders aren't enough. As a high net worth investor, you deserve frequent interactions and personalized, consistent updates about portfolio changes, and to have your questions answered quickly by a skilled professional familiar with your unique investment needs.

Mutual Fund Pitfall #5: The Tax Disadvantage

Due to lack of direct portfolio control and the commingling of assets, investors often sacrifice tax efficiency with mutual funds.

In addition to the fees discussed in Pitfall #3, mutual funds often have certain tax disadvantages that negatively impact returns.

Like stocks, profits on mutual funds in taxable accounts are subject to a **capital gains tax**. But, unlike stocks, you'll also be held accountable for any capital gains the fund incurs as it trades throughout the year. You have no control over when *or* what the fund sells or when it distributes these capital gains to you. Additionally, as discussed in Pitfall #3, mutual fund portfolio turnover can be accelerated by the need to meet investor requests for cash, not only costing you commissions, but also potentially increasing the capital gains you incur.

You could end up paying capital gain taxes twice on one investment (if the mutual fund manager sells shares *within* the mutual fund portfolio *and* if you sell your mutual fund shares). And, in years when a fund incurs losses, capital gain taxes can still be passed on to shareholders. You can lose money *and* still have to pay taxes!

Quick Notes

Capital Gains Tax: A capital gain is the difference between what you paid for an investment and what you received when you sold that investment. Investments include mutual funds, bonds, stocks and other capital assets. If you sold an investment for more than what you paid for it, then you have a gain.

How Is Fisher Investments Different?

We can build you a personalized, separately managed portfolio that isn't commingled like a mutual fund. We can customize the buying and selling of securities according to your tax preferences.[8] As your assets have grown over the years, your tax situation has likely increased in complexity. You've worked hard to build your portfolio and shouldn't have to worry about paying unnecessary taxes.

As a high net worth investor, you deserve a customized approach that can take your specific tax needs into account. It's a level of service you simply cannot get from a mutual fund.

[8] *Fisher Investments is not a tax adviser and does not provide tax advice.*

A Final Word

If you have a portfolio of $500,000 or more, it may be time to graduate from mutual funds to an investment strategy better aligned with your individual needs. We believe Fisher Investments can help you avoid the pitfalls of mutual fund investing so you can build a more secure financial future.

We've helped thousands of investors—each with their own specific time horizons, growth objectives, and income needs—work toward their investment goals. To learn more about what we can do for you, please call us at 800-568-5082. We'd be honored to discuss the possibilities.

Investments in securities involve the risk of loss. Past performance is no guarantee of future results. *M.01.232--Q4101227*

Notes

Fisher Investments™
13100 Skyline Boulevard, Woodside, CA 94062
800-568-5082
www.FisherInvestments.com

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