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Welcome to the inaugural issue of the Bradyco Financial newsletter. I hope you find it useful. If you prefer to not receive any future issues, please click on the "unsubscribe" link at the bottom of this letter or send me an e-mail at Brad@BradycoFinancial.com with the word "delete" in the subject line and I will remove your name from my subscribers list.

## Mutual Fund scandals: Should you care?

With all the news on Mutual Funds in the newspapers, I am often asked should the average mutual fund investor **care**?

Like most anyone who uses or has used mutual funds, you should be **outraged** by the conduct both of those whose deeds have been widely reported in the news media – the hedge fund managers, the mutual fund managers, the mutual fund supervisors and even some regulators at the SEC.

Beyond that, however, **investors need to focus on what affects them the most in dollars and cents**. Unless we get some drastically new revelation, the current scandals – outrageous as they are – have not cost investors nearly as much as the perfectly **legal taking of their money** which are know by the terms "**fund loads**" and "**annual expense fees**."

## What are loads and fees? And why should I care about them?

Mutual funds come in two basic flavors: load and no-load funds. Loads are essentially a sales charge (benefiting the person or organization who sells you the fund) that is either deducted from your purchase (upfront loads). your sale price (deferred or back-end load), or your annual results (level load). A typical upfront load will cost you from **3 to 8.5%** right off the top. No-load funds, by comparison, have no upfront, backend or level fees <u>period</u>!

**Fund expense fees are similar** except that every fund has them since they are used to pay for the legitimate operations of the fund. What's legitimate? There is no simple answer. Some funds charge more because their costs are higher (small international funds, for example) while other funds charge more because they want to make more money.

The cost of these fund expenses can range from **less than 1% of assets** per year to several times that amount. Justified or not, the higher the expenses, the more difficult it is for you to prosper with that fund. When the effect of compounding is taken into account, **fund expense fees can be very costly to investors over long periods of time**.

One way to look at this is to imagine that your favorite baseball team has made it to game seven of the World Series. A friend wants to bet with you on the outcome. You think your team can win. How much would you be willing to bet if you learned before the game began that the umpire gave the opposing team a 3 run lead just for showing up? Sure, **your team could overcome** a 3 run deficit, **but what are the odds**?

Similarly, load mutual funds with high expenses **sometimes** outperform the competition, but **typically they don't**. Because of their high fees (loads and expenses), **they have to do better** than their no-load, low expense competitors j**ust to end up with similar results**. This feat is **hard to repeat** year after year.

Statistics bear this out. Morningstar, Inc., the investment research company, recently did a study that showed that one of the **best predictors** of fund performance over time was not past performance as many investors believe, but the **amount of expenses** (including loads) that are charged. And not surprisingly, **Mutual Funds with low expenses were more likely to**

**outperform their peers than Funds with high expenses**.

In short, while we should all be upset by the atrocious behavior that has been uncovered by the recent investigations, from an individual's financial perspective, the scandals are not nearly as important as the search for no-load, low expense mutual funds.

## What should I do if I already own one of the Mutual Funds in the news?

First, I wouldn't panic. Owning a mutual fund is not like owning a stock. Thus, even if your mutual fund is in the news, it is unlikely that is **going to go broke tomorrow** not matter how bad the news gets. Should you sell? Probably, but first, you should review the possible effects of taxes and fees that may result from selling. While a case could be made that you should sell simply to show your displeasure, the financial reasons to sell are (a) if media reports cause your fellow shareholders sell in mass, this phenomenon could negatively affect the fund's short-term results both from an investment and tax standpoint, and (b) **the residual effects from the past behaviors will make it difficult for even good managers to successfully outperform their peers in the future**.

## What you can do to avoid future problems?

What steps can you take to avoid becoming the victim of a future problem? Look for funds that:

1) are **no-load** (approximately 2500 of the 8200 mutual funds available are no-load)

2) have **low expenses** (typically 1% or less),

## Other desirable traits:

Funds that:

1) have **redemption fees** for investors holding the shares less than a year (to prevent market timing)

2) **close** themselves to new investors if they grow too quickly

3) **do not focus on performance**, especially short-term, **in** their **advertising**

4) whose **managers invest** their own money **in their own funds**, and which

5) have **low turnover** (e.g. they do not do a lot of trading which runs up fees and causes tax headaches for investors).

Finally, if you want to avoid mutual funds altogether, you could invest in an index-based EFT: Exchange Traded Fund which you buy like a share of stock.

Happy Investing.

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