

CHAPTER 9

INVESTMENTS



Investments are the backbone of any good retirement plan. In participant-directed plans like 401(k), the care and attention devoted to investment decisions cannot be overstated.¹ Selecting and monitoring investment options whether they come bundled, as part of an alliance, or completely unbundled, are some of a plan sponsor's main fiduciary responsibilities.²

This chapter is about investments and the key things you need to know about designing, selecting, and monitoring an investment portfolio while protecting yourself from participant-driven lawsuits. After reading this chapter, you should have enough information to research, organize, and evaluate the different investments your current or prospective provider offers you.

Sound investment decisions are even more relevant in light of the bear market of the past couple of years and the recent dot-com meltdown. Ironically, people pay more attention to their investment portfolio in a down or lackluster market environment. Today's high average account balances coupled with a bear market mean people have more at stake and more to lose. As we saw in chapter 3, "Fiduciary Responsibility," the investment selection and monitoring process is expected to become a legal battleground as the great tide of baby boomers retires.

STOCK MARKET NATION

The number and kind of investment products has exploded in the past twenty years. There are now over seven thousand actively traded stocks in the United States and over twelve thousand retail mutual funds.³ In addition, there are thousands of other investment vehicles, such as collective trusts, separate accounts, variable annuities, and private money managers. There are small, medium, and large cap stocks, government and corporate bonds of short, intermediate, and long duration, as well as guaranteed investment contracts and real estate trusts.

This exploding investment universe has dramatically changed the 401(k) marketplace. Only a few years ago, plan sponsors might have selected from a total investment universe of twenty to fifty options. Today, plan sponsors routinely select from fifty, five hundred, and even a thousand available investment options. Not surprisingly, the number of investment options offered to participants continues to grow as well. This trend toward investment choice will continue to grow—fueled in large part by the increasing role of fund supermarkets like Charles Schwab. More choice is usually a good thing, but in the case of 401(k) plans, making sense of the vast investment universe can seem overwhelming for participant and sponsor alike.

INVESTMENT POLICY STATEMENT (IPS)

It doesn't matter if you are a start-up plan or already have an established program; a well-designed IPS is an important fiduciary tool. A well-written IPS is an essential tool for understanding the investment universe and protecting you and your company at the same time. Just as a good financial advisor would never dream of recommending an investment without first understanding your goals and risk tolerance, selecting investments without first considering employee demographics, the number and kind of investment options, and risk-adjusted performance and costs, is now unthinkable. In the investment world, knowing what you don't want or need is just as important as

knowing what you do. A well-drafted IPS helps to establish a logical, coherent framework for the development and adherence of corporate retirement plan investment goals.

There are many benefits that accrue to a company by establishing an IPS. First, it's a written document. The act of sitting down and writing forces a plan sponsor to think through investment decisions while documenting the rationale. By committing decisions to paper, an IPS eliminates secondguessing by making clear the investment selection and monitoring criteria. As the company changes, a chronicle of why decisions were made, an investment history, is left behind. Finally, a well-written IPS also provides a baseline for the ongoing monitoring of investments. When so many 401(k) vendors are offering increased investment choices, having a compass by which to guide the investment selection process is absolutely necessary.

LEGAL BASIS FOR AN IPS

In addition to the practical reasons for writing an IPS, there are legal reasons as well. ERISA requires that all plans have a well-defined funding policy. Post-ERISA case law, DOL releases, industry practice, and growing participant-account balances make the adoption of an IPS a virtual necessity. The spirit of ERISA in this regard is to force plan-sponsor process and discipline. The hallmark of all successful investors is that they develop clear investment goals and strategies and stick to them over time. A well-designed IPS will prevent the plan sponsor from making ill-advised investment selections not only at inception, but throughout the life of the plan. Finally, if you were ever to be sued by a plan participant, an up-to-date working IPS demonstrates procedural process.

BUILDING AN IPS: GROUP DEMOGRAPHICS

The easiest way to begin to construct an IPS is to define the workforce. Are the employees younger or older, on average? Are the employees

knowledgeable about investments? Have they had a retirement plan before, or is this their first one? What is the average income, estimated account balance, and what percentage of employees will participate across various income levels? Getting a handle on the group's demographics will lead to a better understanding of which investment options to include.

THE STRUCTURE OF AN IPS

The structure of an IPS is simple. It describes the company, the investment selection and monitoring process, and the reasons specific investments are included. A well-written IPS defines the objectives of the plan, the asset classes to be included, the decision-making committee members, and sets forth the criteria to be used in the selection and monitoring process. A good IPS generally addresses the following issues:

- ◆ **Mission Statement**—This explains why the plan exists, group demographics (e.g., age, income, education, etc.), whether it is participant or trustee-directed, and whether it intends to comply with 404(c).
- ◆ **Asset Allocation**—What asset classes should be included to allow participants to achieve optimal asset allocation? Which ones are not necessary?
- ◆ **Investment Objectives**—What kind of return is acceptable? What benchmarks will be used to evaluate investments both initially and on an ongoing basis?
- ◆ **Risk Tolerance**—How much risk is the plan willing to let participants take? For example, do you include speculative investments or a fund that makes a large sector bet?
- ◆ **Review Procedures**—An IPS is a living document. A well-written

one lays out the criteria for monitoring and the removal of poorly performing funds. The plan must be periodically reviewed to ensure that it is on track.

The key to a successful investment program is having a well-defined IPS based on your company specifics. Unfortunately, many sponsors, particularly of small plans, spend too little time selecting their investments and even less time monitoring the results. More often than not, companies delegate this responsibility to the salesperson, or even worse, consult a “top ten” fund list. As participant account balances grow, this laissez-faire approach will become increasingly risky. It leaves sponsors open to lawsuits from “aggrieved” participants claiming that because the sponsor did not use a formal process in reviewing, selecting, and monitoring investments, they were subject to poorly performing funds which prevented them from achieving retirement security. A meaningful IPS is an effective tool that will serve as a first line of defense against those kinds of charges.

WHICH INVESTMENT VEHICLES TO USE IN A 401(K) PLAN

ERISA only explicitly prohibits collectibles and large personal property as investment vehicles for 401(k) plans. Plan sponsors are free to select from the following list of investments:

- ◆ Mutual funds
- ◆ Insurance and annuity contracts
- ◆ Bank commingled trusts and deposits
- ◆ Stocks, bonds, and government securities
- ◆ Partnerships, real estate, mortgages
- ◆ Options, futures, and commodities

ERISA requires that fiduciaries diversify plan investments when necessary to minimize the risk of large losses.⁴ Therefore, the prevailing

practice today is to use diversified and highly liquid investment vehicles. For most plans, this means that the choices are annuity contracts, commingled trusts, and, most important of all, mutual funds.

THE COIN OF THE 401(K) REALM: MUTUAL FUNDS

Retail mutual funds have become the dominant investment vehicle of choice in 401(k) plans. One of their most appealing traits is simplicity. A mutual fund pools money from many investors and invests it on the basis of a clearly stated objective. Some invest primarily in stocks, some in bonds, and some in combination. In exchange for their services, they charge a fee based on a percentage of assets known as the expense ratio.

The reason for their popularity is simple—these investments are liquid, highly visible (i.e., they trade on a daily basis and can be easily looked up in the newspaper), and, because many retail fund families spend heavily on advertising, they are familiar to participants.

There are several advantages to using mutual funds.⁵ First, owning many individual securities allows individuals to get instant diversification. This eliminates the risk of putting too many eggs in one basket and provides a cushion when markets fall. Second, mutual funds also offer the advantage of professional management, which in bear markets can often reduce risk and volatility.⁶ Third, mutual funds are liquid and easy to buy. Because they trade regularly, participants can buy and sell shares on a daily basis. And since most mutual funds have modest minimum account purchase requirements, they are perfect for the weekly, biweekly, and monthly flow of most plans. Finally, because mutual funds are registered with the Securities Exchange Commission (SEC), they must disclose key operational information about themselves in a critical legal document, the prospectus.

As I mentioned earlier, there are now more than twelve thousand mutual funds—far more than the number of stocks listed on the NYSE. Many of the larger fund families, such as Fidelity⁷ and Vanguard, sell directly to individuals, while many others, like American Funds, Putnam, and MFS, distribute their products through financial advisor

networks. Either way, each of these companies has spent millions to create a corporate image and brand-name recognition⁸—a necessity in the hypercompetitive world of mutual-fund marketing. As a result, many employers feel comfortable giving their employees access to only name-brand, retail mutual funds whose prices they can track in the daily newspaper.

“MANAGER OF MANAGER” APPROACH

Most of us assume that an individual or a group of individuals working for the fund family makes the fund’s buy and sell decisions. That’s not always the case. There are some companies that, rather than keep high cost investment personnel on their own payroll, contract out the investment management responsibility to third-party, “boutique” money managers instead. Let me explain.

Most investment management firms excel at one or two things. For example, some are good at stock picking (e.g., small cap value) while others excel at bonds (e.g. long-term government bonds). Rather than attempting the difficult task of assembling a stable of top-notch talent for each investment subdiscipline, a few companies (known collectively as “manager of managers”) create investment products in which they hire out the investment management responsibility to the most qualified firm (or firms). One company in particular—Diversified Investment Advisors—has pioneered this approach in the qualified plan marketplace with great success.

Using a series of sophisticated quantitative and qualitative screens, a manager of manager sifts through investment databases and selects style-pure money managers who have a history of delivering consistent and competitive long-term investment results. (This due diligence helps plan sponsors fulfill their obligation in the selection and monitoring of funds, a topic we discuss in detail later in this chapter.) Despite their lack of name-brand recognition, many of these boutique money managers are well known in the close-knit investment community since they often run money for large pensions, endowments and

trusts. Their risk-adjusted returns and style-pure disciplines usually compare favorably to the best retail funds.

There are three solid reasons for considering a “manager of manager” approach. First, as mentioned before, it is very difficult to be good at many investment subdisciplines. By contracting out the investment responsibility, the manager of manager can recruit from a significantly larger talent pool. As an investor, you can be reasonably assured of getting top-notch investment talent; companies who excel at their discipline and maintain style purity—something not all retail funds can claim. Second, manager of managers often negotiate aggressive fee schedules with third-party money managers with the end result competitively priced funds. Third, if an investment manager falters or strays too far from his discipline, the manager of manager can easily replace him without the plan sponsor having to replace the entire fund.

VARIATIONS ON MUTUAL FUNDS: ANNUITY CONTRACTS AND COLLECTIVE TRUSTS

Many insurance companies use brand-name retail mutual funds as investment options within their 401(k) products. The underlying fund is wrapped in an insurance company’s group variable annuity shell for legal and marketing purposes. Unlike mutual funds, these investment vehicles are not required to be registered with the SEC. This allows the insurance companies to sell their product through their traditional distribution channel—insurance agents and employee benefit brokers—many of whom are not securities-licensed to sell registered products. These investments are often marketed as if they were the actual mutual funds. Although similar, annuity contracts are almost always more expensive than the underlying mutual fund because of the additional asset-based fees they tack on. A portion of this additional fee is usually paid to the broker as a commission for selling the product, and the rest is used to subsidize plan costs and to keep the billed expenses low. Since the plans that buy them, start-up and small plans, lack enough total plan assets to offset the true cost of the plan, the service provider imposes the

fee as an additional source of revenue. We will discuss this topic in more detail in chapter 11, “Plan Costs.”

SEPARATE ACCOUNTS AND COMMINGLED TRUST FUNDS

Before mutual funds became the dominant 401(k) investment vehicle, separate accounts and collective, or commingled trusts were common. A separate account is a customized portfolio designed to meet the needs of a particular investor or group of investors. Since these funds are not registered with the SEC nor marketed to the public, their cost is usually less than a retail mutual fund.

A collective trust fund is an investment vehicle created by pooling assets of unrelated retirement plans. They are most often managed by the trust departments of banks. Just like a separate account or annuity contract, these funds are not registered with the SEC nor marketed to the general public, and consequently their cost structure is generally less than a retail mutual fund.

Both of these types of investment vehicles are regaining their popularity due to the pricing advantage they often maintain over retail funds. However, there are disadvantages. Since neither of these vehicles are sold to the general public, and since they are not registered with the SEC, they lack the transparency and name brand caché of highly regulated mutual funds. For participants, this means that it can be difficult to get detailed information about them. We now turn our attention away from investment products to a discussion of the fund selection process and key selection criteria.

DESIGNING A PORTFOLIO: ASSET CLASSES AS BUILDING BLOCKS

Many plan sponsors pick individual “hot” funds rather than design a well thought-out portfolio. The difference is more than semantic. Starting with assets classes rather than the “best” funds is the first step in designing a

sound investment strategy. At a minimum, most plans will include three core options: cash, bonds, and stock. Using these three investment options should enable the participants to devise a sufficiently diversified portfolio to achieve their objectives. In addition, offering three materially different options partially protects the plan sponsor from poor investment-performance claims under the guise of 404(c) regulations. I discuss this topic in more detail in chapter 3, “Fiduciary Responsibility,” and chapter 10, “Employee Communication, Education, and Investment Advice.”

REFINING CORE ASSET CLASSES

As you settle on the core asset classes you want represented, the process of refining becomes more complex. Do you include a money market fund, a fixed guaranteed account, or both? How many total funds do you offer? Do you include a short-term bond fund if you already have a guaranteed account? Defining and refining asset classes takes time and forces the decision-maker to consider for whom the investments are intended and how they will be used. Also, the need to create meaningful distinctions among asset classes must be weighed against the increased difficulty in communicating investment choices to employees. Too many fund options can lead to participant overload and confusion.

THE IMPORTANCE OF INVESTMENT STYLES

In addition to core asset classes, there are also various investment styles to consider when building a core portfolio. Including different styles should enable an investor to create a truly diversified portfolio.

- ◆ **Value and Growth**—Value and Growth styles are the yin and yang of investing. Value investors search out underperforming and out-of-favor companies (relative to the market) whose core business still remains operationally sound. Growth investors, on

the other hand, seek companies whose earnings, sales, margins, and stock price are growing rapidly.

- ◆ **International and Domestic**—Although the United States is the world's largest economy, there are many attractive companies in other countries. Investing outside the United States allows investors to further diversify their portfolio.
- ◆ **Market Capitalization**—Companies of different sizes exhibit different patterns of growth. Generally speaking, companies with market capitalizations greater than \$20 billion form the corporate elite. Midsize companies range between \$2 billion and \$20 billion of market capitalization. Small caps are companies with market capitalizations of between \$250 million and \$2 billion.⁹ General economic conditions affect all companies, but the stock prices of large, medium, and small companies do not move in tandem, and in fact may tend to move countercyclically. When one group goes up, another one may go down, and vice versa. As a result, astute investors create portfolios with companies of different sizes in order to reduce risk.
- ◆ **Active and Passive (Index)**—Indexing began as an academic thesis in the early 1970s and has since transformed the pension industry.¹⁰ Unlike an actively managed portfolio, which fundamentally assumes that some stocks are under- or overvalued relative to others, a passively managed portfolio seeks to replicate an index like the S&P 500, Russell 2000, or Wilshire 5000. Because indexed portfolios do not have to support the research infrastructure of an actively managed portfolio, their cost is significantly lower. Index funds also have lower turnover ratios and as a result have lower overall transaction costs. This lower-cost structure makes them an excellent option for a qualified plan.
- ◆ **Self-Directed Brokerage Account (SDBA)**—Although SDBAs are not an asset class per se, I include them here because of their spe-

cial features. A SDBA allows a participant to buy individual securities like stocks and bonds as well as mutual funds that fall outside of the core investment lineup. As a plan sponsor, you have to make a decision as to whether or not they will do more harm than good for your population. Although virtually all the major 401(k) providers now offer SDBAs, few participants actually use them.¹¹ Yet for the person who knows what she is doing, a brokerage account can be an excellent way to control one's portfolio and enhance one's returns.

- ◆ **Company Stock**—As noted earlier in chapter 6, offering company stock either as a stand-alone investment option or as the basis of the employer-matching contribution, is common in many large company 401(k) plans.¹² I strongly recommend against company stock as a stand-alone investment option except for the largest companies. The fiduciary and operational issues associated with offering company stock in a small or mid-size plan are significant and in light of the Enron and Global Crossing debacles, are best left alone.¹³

Participants often feel an emotional tug to buy company stock despite the risk of over-concentrating their retirement assets. On the other hand, buying company stock in the 401(k) plan gives participants a chance to own shares in the company and to strengthen the relationship between individual and company performance. A workable compromise is to allow participants who receive matching contributions in the form of company stock the option of moving out of the company stock within a reasonable period of time, and to voluntarily limit the amount a participant can invest in, to say, 25 percent. In addition, participants need to be educated about the inherent riskiness of owning an individual security as opposed to a diversified basket of stocks and bonds.



PUTTING IT ALL TOGETHER: FUND SELECTION CRITERIA AND PROCESS

Putting together a well-designed portfolio to meet your participants' needs cannot be reduced to a simple formula. It comes down to doing your homework, using reliable data, making informed choices, and, hopefully, documenting the process. You have to protect yourself when selecting funds. The way you conduct the process speaks volumes about your commitment to your plan and to overall procedural due diligence—two important considerations should you ever find yourself facing a participant lawsuit. If the task seems too daunting, hire a third-party investment consultant to help guide you through the process.¹⁴

There are several criteria to consider when selecting funds. Typically, these criteria are outlined in the IPS, so that the plan has a reference point with which to evaluate funds and performance over time.

- ◆ **Annualized Investment Performance Over 1-, 3-, 5-, and 10-Year Periods**—Investment performance net of all fees is the starting point of historical analysis. This includes both calendar year and annualized information over a number of years. Ideally, investments should have a minimum three-year track record.
- ◆ **Risk-adjusted Performance over 1-, 3-, 5-, and 10-Year Intervals**—The best measurement of investment performance is risk-adjusted returns, since it levels the playing field by handicapping the gross returns by the amount of “risk” taken to achieve those returns. Those with the least risk per unit of return are better, by definition. Risk is defined here by the fund’s volatility (standard deviation) or by its performance relative to the market (beta). Another risk metric includes investment performance during a down market. This is referred to as “downside” risk.
- ◆ **Peer Group (Category) and Comparative Index Performance**—Funds have different objectives and invest in different types of securities. It doesn’t make sense to compare a small-cap value fund to a

large-cap growth fund. How does the fund's performance compare to its best-fit index, and how does the fund's performance stack up against similar funds? These comparisons also help put performance numbers into context. Although a particular category like small cap or international stock may have had a bad year and lost money, your fund may have performed well within its category.

- ◆ **Expenses**—This includes operating expenses, management fees, 12b-1 fees, sub-transfer agent fees, and all other asset-based costs. It is commonly accepted that fund expense is a key determinant of long-term historical performance. The higher the fund's expense, generally speaking, the less likely the fund will perform well. If possible, try to get “institutionally” priced investment options, as these are lower-cost versions of their more expensive “retail” cousins. We will discuss fund pricing in more detail in chapter 11, “Plan Costs.” (Please see the appendix for a summary of different types of mutual fund average expense ratios.)

- ◆ **Manager Tenure**—There is a steady movement of talent within the investment-management world. As individuals move from firm to firm, the portfolios they are running don't shut down. The investment firm just brings on another manager. As you look back over the investment performance history, you want to ask yourself if the same manager is responsible for these returns. If it is someone new, what is her prior track record? Portfolio manager changes are less important for index funds and plain-vanilla bond funds than they are for actively managed stock funds.

- ◆ **Fund Size**—In the world of mutual funds, bigger is not necessarily better.¹⁵ Some have gotten so big that their sheer size dilutes performance. When a fund has too much money to invest, it must buy larger stocks and/or invest in more securities. This causes funds, which may have once invested in small or mid-caps, to become large-cap funds. Further, the impact of individual successful stocks becomes diluted in a big portfolio. When a fund

has tens of billions of assets, it is limited to investing in only the largest companies to soak up its cash. At this point it begins to resemble a high-cost index fund and begs the question: Why pay active management prices for a de facto index fund?

- ◆ **Top Ten Holdings and Portfolio Composition**—Mutual funds are required to disclose their holdings twice a year. Although the information is always dated, the portfolio composition can be instructive, especially if the turnover rate is low. I specifically look at the percentage of assets held in the top ten holdings as well as the total number of offerings. Depending on the client, a fund concentrated among thirty securities may not be as appropriate as one with a hundred holdings.
- ◆ **Turnover Ratio**—This refers to the fund’s frequency of replacing its entire portfolio within a twelve-month period. A turnover ratio of 100 percent means that the entire portfolio turns over once a year. The issue for most investors is taxation of dividends and capital gains. The higher the turnover the more likely the chance of paying taxes. In a qualified plan, however, the issue is not taxation but rather trading costs. Every time a manager buys or sells a stock, there are costs that are charged back to the fund which ultimately reduces performance.
- ◆ **Style Consistency**—Different funds have different charters; some are more loosely defined than others. When it comes to retirement plans, style consistency or the notion of the fund’s “truth in advertising” is a virtue. Offering funds that pursue specific investment objectives and stay within tightly defined investment parameters allows participants to create truly diversified portfolios with minimal overlap.

One of the advantages of working with mutual funds is the SEC-enforced requirement for disclosing material information on a regular basis. As a plan sponsor, you can research most mutual funds over the Internet. You can also subscribe to a mutual-fund database, such as

Morningstar or Lipper to access this information. Or you can hire an investment consultant to perform the required investment analysis. (We will discuss the role of third-party advisers in chapter 13, “Putting It All Together—Vendor Selection.”)

ONGOING MONITORING

At this point, you’ve looked at your company demographics and plan statistics. You’ve determined core asset classes, delineated your selection and monitoring criteria, selected funds, and recorded the process on paper in the IPS. The next step is to monitor the investments on a regular basis. This means tracking performance against the monitoring criteria on some regular basis such as semi-annually or annually. By tracking each fund’s performance on a regular basis, you can ensure that each fund remains true to its purpose and meets the minimum benchmark requirements as set forth in the investment policy statement. Also, by keeping meeting notes, you demonstrate commitment to a due-diligent process. Over time, you may have to replace a fund that consistently fails to meet the minimum criteria for continued inclusion in the plan.

Investments are the backbone of a great 401(k) plan. That said, you may have the best investment lineup in the world but if no one participates in the plan, all your hard work is in vain. This brings us to employee education and communication, our next topic.

Notes

1. “Plan sponsors are sometimes under the mistaken impression that participant-directed 401(k) plans remove the fiduciary obligations traditionally found under defined benefit plans.” “A Matter of Policy,” Meg Glinksa, *CFO*, August 2000, p. 100.
2. “*Failure to prudently select*: When a plan fiduciary or committee fails to properly select the investment managers for the 401(k) plan, the participants might seek to recover the difference between what they actually earned and what they might have earned had an appropriate selection been made.

Failure to monitor: In a participant-directed plan, if the plan fiduciaries fail to monitor the performance on a periodic basis and that performance over time is found to be deficient in comparison to benchmark indexes, the fiduciary might be charged to make up the difference between actual performance and the benchmark index performance under the theory that the fiduciary failed to monitor the investments and to take corrective action.”

The 401(k) Plan Management Handbook, Jeffrey M. Miller and Maureen M. Phillips, Irwin Professional Publishing, 1996, p. 145-146.

3. 7,181 stocks; 12,549 mutual funds—Morningstar Principia Pro—through March 31, 2001.
4. ERISA requires a plan fiduciary to “discharge his duties with respect to a Plan solely in the interest of the participants and beneficiaries . . . by diversifying the investments of the Plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.” 29 U. S. C. §1104(a)(1)(C).

The degree of investment concentration that would violate this requirement to diversify cannot be stated as a fixed percentage, because a fiduciary must consider the facts and circumstances of each case. The factors to be considered include (1) the purposes of the plan; (2) the amount of the plan assets; (3) financial and industrial conditions; (4) the type of investment, whether mortgages, bonds or shares of stock or otherwise; (5) distribution as to geographical location; (6) distribution as to industries; (7) the dates of maturity. H. R. Rep. No. 1280, 93 Cong., 2d Sess. (1974), reprinted in 1974 U. S. Code Cong. & Admin. News 5038, 5084-85 (Conference report at 304).

5. Although retail funds offer many advantages, they are not perfect. The most common criticisms are listed below:
 - ◆ Some do not follow their investment mandate (style drift).
 - ◆ Some are expensive.
 - ◆ Very few actively managed funds consistently outperform their best-fit index.
 - ◆ Some have problems with cash flows (i.e., having to keep a portion of the

- fund's assets in a cash reserve) since they are subject to the whims of after tax investors who may pull their money out at the slightest hint of trouble.
- ♦ Many are run solely to maximize the collection of assets with its heavy emphasis on marketing past performance and not necessarily to meet long-term goals and objective of investors in long-term retirement plans.
6. Putting money into actively managed mutual funds was often derided as a “loser’s game” by the financial press during the last years of the great bull market, since many of the large, well-known funds underperformed the S&P 500 Index. At the same time, these popular “financial journalists” extolled the virtues of buying and selling individual securities. The end of the bull market has greatly reduced the number of “do-it-yourself” and “day trading” proponents.
 7. Besides its stable of well-known no-load funds, Fidelity also offers another set of funds known as the “Advisor” series which they distribute through third-party intermediaries.
 8. U.S. mutual fund companies spent \$220 million to advertise their wares in print and on television in the first six months of this year, a 29 percent increase from the first half of 1996, according to Competitrack, a New York firm that tracks advertising.
 9. Market capitalization is a convenient way to categorize stocks and is defined as the share price multiplied by the number of shares outstanding. Morningstar uses the five bands below to categorize the stocks and mutual funds it tracks in its databases.
 - ♦ **Giant**—greater than \$45,323 billion
 - ♦ **Large**—between \$8,711 and \$45,323 billion
 - ♦ **Mid**—between \$1,388 and \$8,711 billion
 - ♦ **Small**—between \$245 million and \$1,388 billion
 - ♦ **Micro**—less than \$245 million

Morningstar Principia Pro, April 30, 2002.

10. In 2001, approximately 12% of 401(k) assets were invested in Index Funds. In 2001, approximately 12% of 401(k) assets were invested in Index Funds.
Source: Speech made by a Consultant from Cerulli Associates, Inc. at the Scudder