

Why funds can underperform individual securities.

I tell people to consider buying individual stocks and bonds rather than funds, where appropriate. Is it safer? I think so. Some ask "Frank, why do you fight that battle? Why argue, just give them what they want." I fight that battle because it is worth fighting. There can be significant difference in the return, a greater and more clear ability to analyze risk, and opportunity for better ratio of risk to return.

What makes the difference?

There is so much cost that isn't disclosed. Funds report the expense ratio. But the cost of transactions is born by the fund and not included in the expense ratio. Often you see turnover of 30% in a fund. I am concerned that the commissions on that turnover could corrupt decision making.

Some of the "argument" can be made in terms of what characterizes a liquidity crisis, which is when a fund needs to make cash available to meet a surge in withdrawal requests. Values are thrown out the window and funds have to liquify to meet withdrawal demands. My calling is to simplify and clarify the investor's investments, to put the money in the best place to pursue their goals. Who doesn't want the best place? Is the best place always the same for everyone? Not completely. That's oversimplified so before making any investment decision, one should consider objectives (growth, income, safety) and cost and liquidity for each investment alternative.

An investment is risking one's capital for a return, no guarantees! Funds came about as a way for investors and employers to drip money into investments and retirement vehicles. While they offer professional management and diversification, I don't want a stranger deciding whether to put my money in Fed Ex or General Motors. Especially at upper management levels. Surely there are negotiated agreements between fund managers and corporate managers on how to place their stock. You can be sure fund managers and corporate executives are trying to place some airline stock right now.

It's a foreign concept for some to know where their money is. They work and invest and trust someone to handle this function. Like your health care, one should take personal responsibility for your investments. Trust in a fund professional, in my opinion, isn't enough. It is nice for me because I can say to a client, "this company is in the right place but that company may have some problems."

Frank Givens, CPA

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