Over 1,700 Funds

MUTUAL FUND BUYER'S GUIDE 1994

Five-Year Profit Projections • Safety Ratings
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All-Star Ratings • 1,700 Charts • and more

Stock Funds • Bond Funds
Tax-Free Funds

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The author is Editor of

Mutual Fund Forecaster
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The author is also Managing Editor of

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Introduction

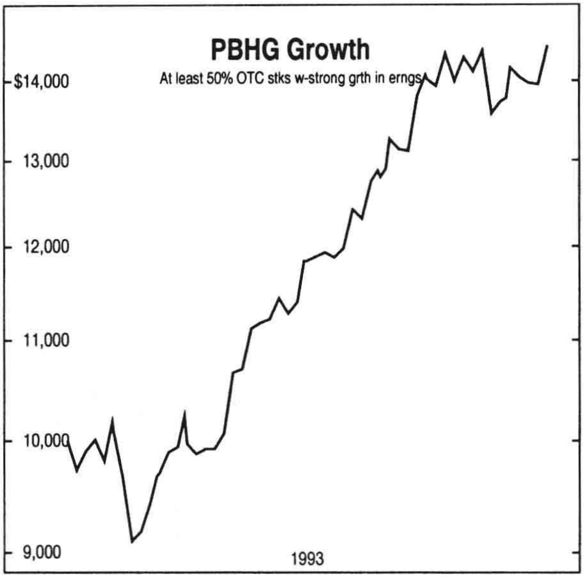
Financial historians may eventually look back on the 1990s as "The Decade of the Mutual Fund" . . . were it not for the fact that the 1970s and 1980s were also "decades of the mutual fund." In truth, the mutual fund expansion of the last 20 years has been the single greatest financial boom ever. In 1974, the entire mutual fund industry managed $34 billion. Today, the industry is more than fifty *times* $34 billion – approximately two trillion dollars of Americans' monies under pooled, professional, investment management.

This growth is without parallel in financial history. But it is easy to explain. Once a business characterized by a handful of relatively homogeneous funds, the mutual fund business has evolved into a vast heterogeneous industry offering an extraordinary breadth, and depth, of choices for investors.

Beginning with the invention of money market funds in the early 1970s, the mutual fund industry has grown to encompass funds that invest in virtually every publicly-traded financial instrument invented by man – stocks, bonds, options, futures, derivatives; both domestic and foreign securities. And within these groups, there are numerous subclassifications such as growth stocks, income stocks, and specialized industry stocks. On the income side, investors can choose from funds specializing in every type of bond, from Treasuries to high and low-grade corporates, municipals of all quality ratings, exotic collateralized mortgage obligations, zero-coupon issues, and issues of foreign governments, to name just a few. In the money market arena, not only T-bills and CDs are represented, but also commercial paper, Eurodollars, repos, put bonds . . . you name it and a mutual fund owns it.

The only financial instruments not now owned by mutual funds are those that have yet to be invented, and you may rest assured that this dynamic industry will own those, too, as soon as they are created. Indeed, many of the most innovative financial instrument derivatives are being developed to cater to the investment needs of mutual funds.

The proliferation of mutual funds, and the securities in which they invest, has been an extraordinary service to the American public. The better-than-50-fold growth of money under management in just two decades is the proof. More choices means that more Americans own funds, in the process obtaining instant diversification, while avoiding the plagues of market complexity and manipulation that so often ensnare investors attempting a "do-it-yourself" approach to stocks and bonds. Furthermore, the investments are protected by a rich tradition of success and a regulatory apparatus that, while not perfect, effectively deters most abuses.



The top diversified domestic equity fund in 1993 was PBHG Growth, up +47%.

But with proliferation of choice comes complication and risk. As more investors transfer their savings and investments to mutual funds, the average level of investor sophistication is bound to fall . . . in inverse relation to the need for more sophistication in an increasingly complex marketplace. The mutual fund public, in other words, must be better informed of their choices, not less. And they must have information that will enable them to exercise these choices intelligently. That is the role of this book, our first annual edition of the *Mutual Fund Buyer's Guide.*

It was relatively easy to select a fund forty years ago when only 150 were on the market. Today, with thousands of funds from which to choose, and with mutual funds promoting themselves in every available medium, buy-and-sell decision-making is vastly more difficult. The chance of making a bad decision is greater simply because the breadth of choice is wider. To illustrate the complexity of the choices facing investors, consider that there are now more mutual funds than there are NYSE and Amex-listed common stocks.

Furthermore, as with all industries in a capitalistic society, the mutual fund industry is entirely self-serving. It offers investors a broader choice of funds not because it is necessarily better for investors, but because it is *profitable.* The industry also understands that in a financial bull market, such as that which has prevailed the last two decades, it can increase its profitability by other means, as well. The most disturbing of these is the rapid escalation of loads and fees.

Even though fund sponsors realize enormous economies of scale with larger funds, and even though funds have, indeed, become much larger, fees are spiraling upward. Today, the average fund keeps for itself approximately $1 of every $6 of portfolio profits – mainly to compensate portfolio managers and to support far-flung marketing efforts, little of which benefits fund shareholders.

Plus, sponsors charge investors an average of 3% in direct sales and redemption commissions. That so little price competition exists in an otherwise competitive industry, can be attributed only to the ignorance of investors. Fund investors must become better informed, and recognize that choosing the most *cost-effective* fund alternative is almost as important as choosing the fund whose portfolio will perform the best. The *Buyer's Guide* is dedicated to helping you here, too.

This is the first-ever book that brings to investors the entire panoply of critical mutual fund investing information in a single low-priced volume. High-precision charts, concise summaries of costs and benefits, historical performances, and how-to invest information, all capped off with a unique Star Rating System for each of more than 1,700 of the leading funds in America – funds that, in aggregate, account for more than 98% of all the assets in equity and bond funds.

The investment choices are yours. And now, the information and evaluation you need is, literally, in your hands. Happy reading, and good investing!

Chapter One

Guide to Mutual Funds

Mutual funds are among the most flexible and potentially advantageous investments in the financial universe. They are equally suited to beginning, intermediate, and advanced investors.

What is a Mutual Fund?

A mutual fund is simply a corporation (or business trust) that sells shares of its stock to the public, and invests the proceeds in securities, such as stocks and bonds, of other companies. Mutual fund stockholders share in the income, profits, and losses of their funds' investments. At the end of every business day, the typical fund calculates the total market value of all of its investments and other assets and deducts its liabilities to determine the precise value of each outstanding share. That value is called its "net asset value per share."

Mutual funds originated in Europe in the early 1800s, attaining great popularity in Scotland and England in the middle part of that century. The first mutual fund in the United States was formed in 1924. The industry has grown rapidly since, and today consists of over 3,000 funds investing approximately $2 trillion on behalf of stockholders.

Funds, also known as "investment companies," are broadly classified into two categories, open-end and closed-end.

Open-end funds are nearly always *open* to investors, who at any time can buy new shares from the funds at net asset value, or sell (redeem) the shares they own back to the funds, also at the net asset value. Some open-end funds charge a sales commission (also called a "load") to investors when they buy or sell shares, and are therefore known as "load" funds. Funds that do not charge a load are called "no-load" funds.

In contrast to open-end funds, closed-end funds make a single public sale of shares to the public, and then *close* their doors to new investors. Such funds will not sell new shares to the public nor will they repurchase shares from existing investors. To enable stockholders of closed-end funds to sell shares from time to time, and to allow other investors to buy shares, closed-end funds trade on stock exchanges or in the over-the-counter market just like thousands of other stocks. Investors buy and sell them through a stockbroker (who will charge his usual commission) at whatever price the market determines. Depending on market conditions, that price may be above, below, or the same as the fund's net asset value.

For beginning investors, open-end funds are usually more attractive, for they can always be bought and sold at their net asset value. Closed-end funds may be particularly advantageous investments when they sell at a discount below their net asset value.

Advantages

The key advantages of mutual funds are diversification, liquidity, and professional management. Many funds also provide cost advantages and offer a plethora of useful features.

***Diversification*:** Without question, the single greatest advantage of a mutual fund is that it is a *portfolio* of many securities. There is, indeed, safety in numbers. Portfolios consisting of many securities are safer than portfolios with few securities. Most investors, especially those with limited assets, are unable to purchase a large number of different securities. Mutual funds enable individuals to obtain partial ownership of portfolios consisting of dozens, or even hundreds, of different stocks, bonds, money market instruments, and other securities, all for an investment of just a few hundred or a few thousand dollars.

***Liquidity*:** The ability to sell an investment at a moment's notice is an important attribute. Investors can sell some or all of their shares back to mutual funds on a single day's notice, usually without any of the costs entailed in liquidating a portfolio of individual stocks or bonds. Closed-end funds can be sold in the open market at any time at the cost of a small commission.

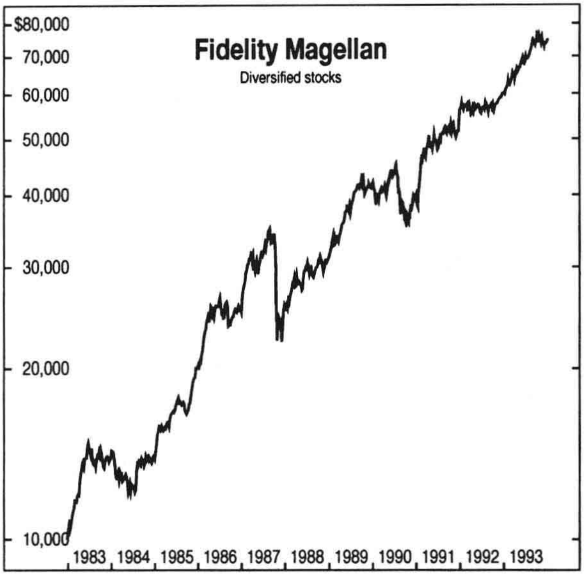
***Professional Management*:** Mutual funds provide professional portfolio supervision for investors that are unable or unwilling to manage their own portfolios. Nevertheless, professional management is probably the most overstated advantage of mutual funds. In truth, management is "professional" only if it generates a reasonable return on an investment portfolio relative to the risks assumed. Some fund managers do, indeed, consistently beat the market in which they are investing by exercising superior security selection, market timing, or portfolio strategies. Others, however, have inferior track records.

These "professional" managers are little better than "amateurs." Overall, the average mutual fund portfolio slightly underperforms the market. Somewhat less than half of all professional portfolio manages actually "earn their keep." One purpose of the *Buyer's Guide* is to help you separate the wheat from the chaff.

Low Trading Costs: Small investors usually have to pay commission rates equal to several percent of the amount of their investment when they buy and sell securities. Mutual funds buy and sell securities in large blocks and obtain much lower trading costs, passing the resulting savings on to shareholders.

Retirement Plans: Most funds offer several types of accounts, including tax-deferred retirement plans, such as Keoghs and Individual Retirement Accounts (IRAs). Fees, if any, for these special services are modest.

Dollar Cost Averaging: Because mutual funds can be purchased in small-dol-

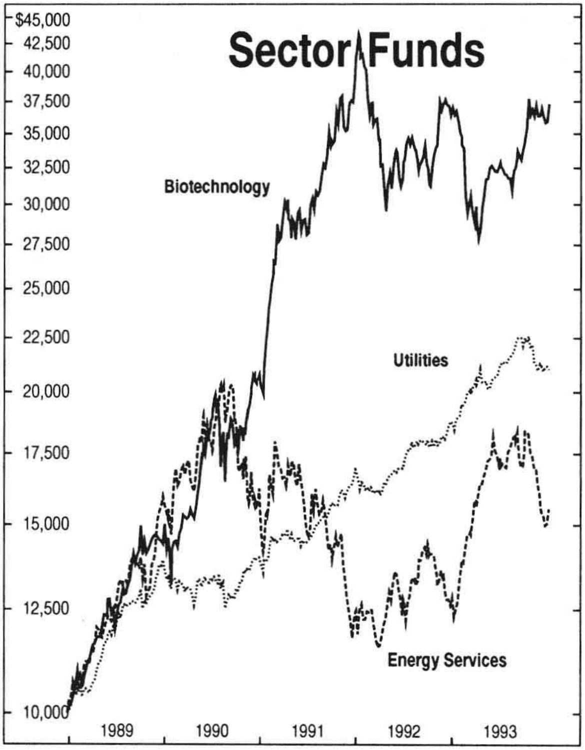


Reward and risk possiblities are abundant with mutual funds. In the last decade, Fidelity Magellan soared eight fold, while 44 Wall Street Equity contracted sharply.

lar amounts at periodic intervals, even in fractional shares, they are ideal vehicles for "dollar cost averaging." This intriguing method of accumulating fund shares is analyzed in detail in Chapter 4. Briefly, dollar cost averaging *guarantees* that an investor's average cost of fund shares will be *less* than the average of the prices at the times the shares were purchased. Some funds will even arrange to have amounts regularly transferred from your bank account to automate your DCA program.

***Automatic Withdrawal Plans*:** Many funds also allow investors to gradually sell their shares in an amount and frequency of their own choosing, and will mail a check for the proceeds monthly or quarterly. This enables investors to receive a periodic cash flow from their investment irrespective of a fund's yield or the normal frequency of its distributions.

***Distribution Reinvestment*:** At shareholder request, mutual funds will automatically reinvest all income and capital-gains distributions in additional shares at no charge. In other words, you can have your profits in cash or in more stock, an option most stock investors do not have.



Fidelity offers investors a choice of three dozen "sector" funds specializing in individual industries.

Dividend Direction Plans: These programs allow you to reinvest dividend and capital-gain distributions received from one fund into another fund in the same family.

***Ease of Investment*:** Buying a fund is "as easy as pie" – certainly much easier than opening a bank account. Later in this chapter, we shall show precisely how easy it is to open a mutual fund account.

***Special Purpose Funds*:** The mutual fund industry has expanded and become extremely diverse during the last two decades. Funds are now available that invest in almost every type of security imaginable. Here is a representative, but by no means exhaustive, list: blue chips, growth stocks, small-company stocks, over-the-counter stocks, preferred stocks, high-grade corporate bonds, junk bonds, Government agency bonds, Ginnie Maes, U.S. Treasuries, zero coupons, gold stocks, health-care stocks, computer stocks, utility stocks (and stocks of many other specialized industries), gold bullion, convertible securities, Treasury bills, bank CDs, commercial paper, and foreign stocks. Regardless of the type of investment you seek, there is likely to be a mutual fund to serve you with a diversified portfolio.

***Telephone Switching*:** Many mutual fund organizations allow investors to switch from one fund to another via telephone instruction, or even to allocate their investments among multiple funds. This service, usually available at no charge, enables investors to switch objectives with a minimum of bother. One extremely popular application of this feature is to switch back and forth between a growth-oriented mutual fund and a conservative income or money fund on the basis of an investor's expectations about the direction of the stock market.

***Less Paperwork*:** One nice thing about funds is that they do most of the paperwork for their stockholders. Capital gains and losses on the purchase and sale of securities, as well as dividend and interest earnings, are neatly totaled for each stockholder at the end of the year for his or her tax purposes. Funds also do all of the day-to-day paperwork chores, including handling of stock certificates, brokerage tickets, statements, transfer agents, stock offerings, etc. All investors have to do is send their money to a fund and it does the rest.

Costs of Mutual Fund Investing

Mutual funds are not a one-way road to riches. For every reward on Wall Street, there is usually an offsetting cost or risk; for every advantage, a disadvantage. In addition to the risk of poor performance, an investor owning a mutual fund subjects himself to a variety of costs and charges.

***Sales Charge*:** Many mutual funds impose a "sales charge" or "load" on investors that buy new shares. Sales charges can range up to 9.3%, although the maximum charge ever published by a fund is 8.5%. This means that $85 of a $1,000 investment is kept by the salesperson or sales organization, and only $915 worth of fund shares are actually purchased. Note that the sales fee equals 9.3% of the amount actually invested. Sadly, most funds quote their sales charges as a percentage of the cost of shares purchased *plus* the commission. This somewhat deceptive practice makes commission rates appear to be

An index fund like Vanguard Index 500 lets you virtually "buy the market."

slightly lower than they really are. The fees shown in the *Buyer's Guide* are calculated to correctly show the actual percentage commission rate. Sales charges are usually reduced for larger transactions. Many mutual funds, including virtually all money market mutual funds, are "no-load" and do not charge any sales loads at all. (See Chapter Three for more details on maximum load charges.)

***Redemption Fee*:** When an investor sells – i.e., redeems – shares back to a fund, he may incur another charge, a redemption fee. Most funds do not levy any redemption fee at all, but some charge up to 5.3% of the amount of money initially invested. These "back-end loads," also known as contingent deferred sales charges, are sales charges deducted at the end of the transaction rather than the beginning. However, the charges usually scale down with the passage of time. For example, a fund might charge a 5% redemption fee on the sale of shares sold within one year of purchase, while shares sold in their second year of holding would incur a 4% fee, and so on down to a 1% fee in the fifth year, and nothing thereafter.

Other funds levy a small redemption fee on the full sale value of shares sold within a specified period – say, within the first six months or one year after purchase. Such redemption fees are usually imposed to discourage investors from frequent trading.

Redemption fees and sales charges assessed on a particular value of an investment have the same effect on profits and losses. Whether a fund charges a 5% load at the time shares are bought, or charges a 5% fee to redeem, the effect is *exactly* the same on an investor's final value. However, when a redemption fee is levied only on the value of the shares purchased, and if the fund appreciates in value between the times of purchase and sale, a redemption fee costs less than an initial sales charge.

***Reloading Charge*:** Nearly all funds permit investors to automatically reinvest all capital-gain and income distributions in new shares with no sales charge. However, a few funds levy what might be called a "reloading" charge on reinvestments of income distributions.

***Hidden Load*:** A growing, and particularly obnoxious, practice in the mutual fund industry is the imposition of hidden-load charges on investors. Hidden loads are enacted pursuant to so-called "12b-1 plans," also called "distribution plans." Most new funds now levy these charges, and more are adding them. They typically range as high as ¾ of 1% per year.

The money that fund sponsors receive from hidden-load charges supposedly benefits existing fund stockholders by funding promotional efforts that hopefully increase the size of the fund and lead to reduced management fees and operating expenses as a percentage of assets. In practice, however, it is impossible for such cost reductions to offset the hidden loads themselves. Furthermore, large funds lack the operating flexibility of small funds, so if promotions financed by hidden-load charges significantly increase the size of a fund, they may ultimately actually harm existing fund shareholders.

***Service (or Administrative) Fees*:** Beginning in 1990, some mutual funds began levying this fee to compensate brokers for "servicing" the accounts of investors that bought fund shares through their firms. These charges typically range up to 0.25% per year. They are nothing more than a different type of hidden load. Whether such charges are said to be pursuant to a distribution plan or an administration services agreement, they end up enriching salesmen and fund sponsors, not investors.

Additional Costs

All of the charges discussed above should be avoided by mutual fund investors, other considerations being equal. For example, sales charges, redemption fees, hidden loads, and service fees are not necessary to the operation and management of a mutual fund portfolio; they merely pay, directly or indirectly, for sales efforts. The fact that many of the best funds impose *none* of these charge is the ultimate proof they are completely unnecessary.

In addition, mutual funds require their shareholders to bear the burden of several other types of expenses. Though necessary, these costs are usually (though not always) quite modest. Most investors would incur far greater costs themselves if they bypassed mutual funds and purchased stocks and bonds directly. Nevertheless, informed investors should be aware of these additional costs of fund ownership.

***Transaction Costs*:** As a fund buys and sells securities, it incurs brokerage commissions. Transaction costs are normally much lower for mutual funds than for individual investors because funds buy and sell in large quantities. Nevertheless, all trading costs are ultimately borne by shareholders. The more actively a fund turns over (trades) its portfolio, naturally, the more transaction costs it will incur.

***Portfolio Management Fees*:** Every mutual fund contracts with an investment advisor to make investment decisions. Shareholders must bear the cost of the fee paid to the manager, which usually ranges from 0.25% to 1¼% of fund assets per annum. Generally, the larger the fund, the lower the percentage fee. Annual management fees in excess of 0.75% should generally be considered excessive.

***Operating Expenses*:** Mutual funds incur various day-to-day operating costs, including rent, telephone expense, employee salaries, prospectus and annual report printing, and so forth. As these expenses are incurred, they are paid from fund assets, and therefore reduce stockholders' returns. Typical fund operating expenses range from 0.10% to 1¼% per year. Added to management fees, total operating expenses exceed 2% per annum for some funds. Total annual expenses average 1.45% for all equity funds, 1.05% for all taxable bond funds, and 0.85% for all tax-free bond funds.

Balancing the Pluses and Minuses

The nice thing about free markets is that they give investors extraordinarily wide choices. Not all funds, for example, offer all the attractive plans and features enumerated in the list of advantages above. And many funds levy obnoxious layers of expenses and fees on their shareholders. However, with thousands of mutual funds from which to choose, investors can find the features they need without assuming costs they don't need.