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March 19, 2010

Vanguard's New Value Fund

Vanguard's newest fund, Explorer Value, opened to investors with a subscription period beginning March 16. Until March 30, money invested in the fund will be held in cash. As we mentioned back in December, when Vanguard first filed papers to open the fund, Explorer Value will focus on small- to mid-sized value companies, which Vanguard sees as an open niche in their actively managed fund lineup.

Like its namesake fund, Explorer, the new fund is employing a multiple-manager approach right off the bat, with seven portfolio managers from three management firms each handling a piece of the fund's assets (the three firms will initially each be managing a third of assets). Two of the advisory firms are new to Vanguard, Cardinal Capital Management and Sterling Capital Management, while the third, Frontier Management, has been managing a portion of Morgan Growth's assets since 2008.

Explorer Value has a 0.59% expense ratio and requires a \$10,000 minimum initial investment. If the three management teams can work in concert and put together a compelling portfolio, it could be a good option for the small- to mid-cap portion of a portfolio, especially since it will be just one of three actively managed funds in that niche at Vanguard (the other two being the index-like Explorer and the quantitative Strategic SmallCap Equity). Vanguard says the portfolio should have fewer than 200 stocks in it, but if the numbers are close to that maximum it will mean that, on average, each manager is holding 70-plus stocks, considering overlapping positions. This might work, but then again it might simply yield index-like performance. Vanguard's SmallCap Value Index holds just under 1,000 stocks. At the moment, there is nothing compelling about this offering that makes us want to own it. Should performance explode out of the box, we'll have to rethink our position.

A Warm Tech Winter

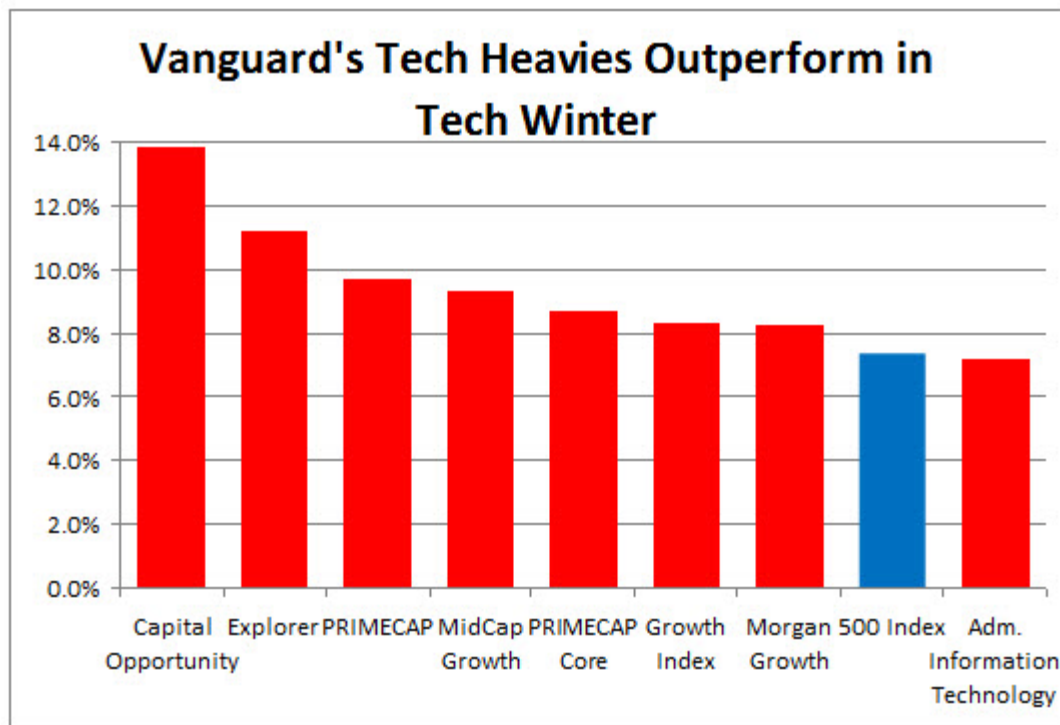
Spring is just around the corner (indeed, most of the nation has already sprung ahead to daylight savings time), but around this time of year, we like to look back to the Tech Winter we've just weathered. If you recall, in November we wrote to you about what we call Tech Winter—the four month period from November to February during which technology stocks have traditionally outperformed. We've tracked this phenomenon over the past 25 years and found

In This Issue

- **Vangua
New Va
Fund**
- **A Warn
Tech
Winter**

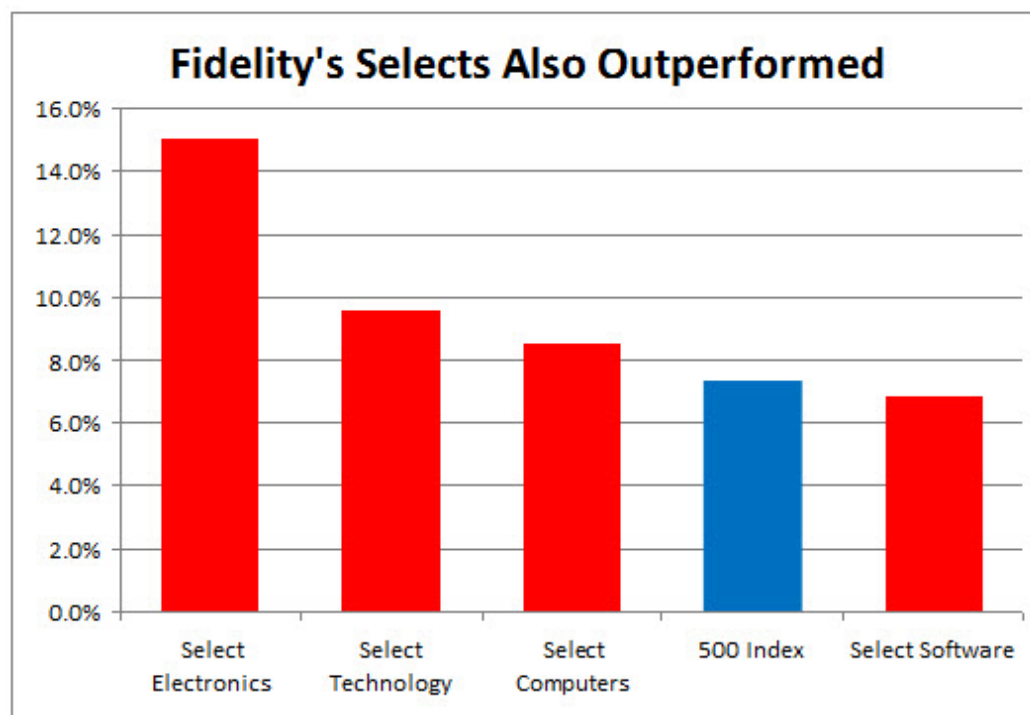
overwhelming evidence of the trend. While it is not a sure thing every year, the most recent Tech Winter certainly supports the theory.

From November 2009 through February 2010, the most tech-heavy funds at both Vanguard and Fidelity, with only a couple of exceptions, outperformed the S&P 500. Unlike last year, when the funds we use to track this trend beat the index by losing less, this year, tech-heavy funds outperformed by gaining more, a welcome change.



Source: Adviser Investments

500 Index returned 7.4% from the start of November 2009 through February of this year, and, as mentioned above, nearly all of Vanguard's tech-heavy funds surpassed that. The notable outperformers were Capital Opportunity, which gained 13.8% over the period, Explorer (11.2%—also helped by small-cap stocks' relative outperformance this year) and PRIMECAP (9.7%). MidCap Growth, Morgan Growth, Growth Index, PRIMECAP Core and Explorer also beat the index, albeit by slimmer margins.



Source: Adviser Investments

Fidelity's tech-focused Select funds were also Tech Winter outperformers, although Select Software failed to beat the index. The best of the bunch, Select Electronics, gained 15.0%, while Select Technology (9.6%) and Select Computers (8.5%) had strong showings as well.

A big part of why we like to talk about the Tech Winter phenomenon is because it highlights the skills of some of our favorite managers and their dexterous stock-picking, which we put to use in our clients' portfolios. Among those managers is the team at PRIMECAP, responsible for Capital Opportunity (37% allocated to tech through February), PRIMECAP (31%) and PRIMECAP Core (25%). They are very fond of tech investing, but do it intelligently, hedging their bets by spreading a majority of their assets across multiple sectors. The Fidelity funds we hold on behalf of our clients with tech holdings greater than the S&P 500's 19% allocation were a mixed bag this Tech Winter, with Contrafund (28% in tech through January) lagging the index with a 6.4% return over four months, while Magellan (28%) outperformed, gaining 8.4%.

As we always caution when looking at these shorter-term trends, we do not advise making drastic moves in your portfolio in an attempt to catch four months of potential outperformance. What we do recommend is keeping a diversified portfolio with tech exposure, so that you reap some benefit from Tech Winter without adding unnecessary risk. This philosophy enhanced our client portfolios this Tech Winter and should do so for many years to come.

About Adviser Investments

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