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June 15, 2007

### **An Inflation-Protected ETF?**

Vanguard had hardly gotten its four bond ETFs (exchange-traded funds) up and running before it was back at the SEC, filing for an exemption to allow the company to offer an ETF based on its Inflation-Protected Securities fund. It's not set in stone as to when or if this fund will ever see the light of day (there are still some regulatory hurdles left), but it would feature something new in the ETF world: Active management.

While the idea of an actively-managed ETF is intriguing, it should be pointed out that the fund the ETF would track is about as drab as can be. There aren't very many inflation bonds in existence, meaning that most of the fund's "active" management is taking place at the margins. Inflation-Protected Securities holds only 22 bonds, and had about 50% turnover last year, mostly attributable to outflows of over \$800 million (about 10% of assets), as opposed to the managers actively trading securities.

One could also make the argument that many index funds and ETFs bear the influence of active management as well—indexes are put together by people (or computer models designed by them) and back-tested extensively until they exhibit the desired performance characteristics. For example, the composition of the S&P 500 index, regarded as one of the oldest and best-known measures of the U.S. market, is determined by a board, which periodically adds and removes stocks from the index to keep it in tune with its pre-determined objectives.

The prospect of an actively managed, inflation-protected bond ETF makes for an interesting story, and if the fund ever shows up, it should be a good, low-cost alternative for bond fund investors. But until that time, we already have plenty of quality bond fund options with Vanguard and Fidelity's existing funds and ETFs.

### **Fidelity Manager Changes**

As of June 1st, the Fidelity China Region fund has a new manager, Wilson Wong, who succeeds K.C. Lee. Wong already manages a number of Asia/Pacific portfolios, all of which are only available to overseas investors, and he has also co-managed International Small Cap since 2005 (he will continue in this role). He joined the firm in 2000 as a research analyst, covering the Asia/Pacific region, moving up after a year to be the technology sector leader in that area,

eventually joining the global research team in 2003. Wong's prior management experience is comprised of an overseas technology portfolio as well as the Advisor Korea fund. Before joining Fidelity he worked out of the Hong Kong offices of General Electric and Merrill Lynch.

This move does not change our rating of China Region as a "hold," but we prefer Fidelity's broader international funds such as International Small Cap Opportunities, International Discovery and Diversified International to more country-specific ones, such as China Region, for our clients' portfolios.

Fidelity also made a switch on one of its many Select funds on June 1st, replacing Yolanda Taylor of Select Brokerage and Investment Management with Benjamin Hesse. Hesse will continue to manage Select IT Services, which he took over as solo manager at the beginning of this year (he'd co-managed the fund since 2006). So far he has followed a similar path to so many other Fidelity fund managers over the years, getting his start as a research analyst in 2005, following the processing and analytics industries. Prior to joining Fidelity he was with Credit Suisse, working with small-caps.

As always, we caution investors away from buying sector-specific funds unless they have a high tolerance for risk.

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