ADVISER INVESTMENTS

ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

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In This Issue

Fidelity's New President

Last Friday, February 20, Fidelity Investments announced that Charles Morrison would succeed Ronald O'Hanley as president of the company's Asset Management division. The appointment comes a month after O'Hanley unexpectedly decided to leave the firm.

Our impression of Morrison, 53, former president of Fixed-Income and vice chairman of Pyramis Global Advisors, is that he will be a good fit for the new role. His responsibilities will include overseeing Fidelity's investment divisions—including the firm's lineup of mutual funds—totaling $1.9 trillion in assets. It's a mission critical posting, one that will see him helping with future investment product development, as well as offering support to Fidelity Investments President Abigail Johnson.

Morrison is a Fidelity lifer, having joined the firm as a corporate bond analyst in 1987 after earning his MBA from Harvard Business School. He began managing Trust accounts in 1990 and was promoted to vice president of Fidelity Management Trust Company in 1992. During this time, he was responsible for managing a variety of short-term and broad-market bond portfolios. From 1995 to 2002, Morrison managed a handful of Fidelity's bond funds, including Short-Term Bond, Spartan Short-Term Bond and the Advisor Short Fixed Income fund. He also managed the fixed-income sleeves of the Asset Manager and Asset Allocation series of funds. In 2002, Morrison took on his first leadership role at Fidelity, overseeing several strategic projects for the company and as head of the Bond Group. From 2004 to 2009, he served as president of Fidelity's Money Market Group.

As mentioned above, we think this is good news for Fidelity. While investors in the firm's funds will not notice any changes as a result of Morrison's promotion, he has a deep appreciation for the firm's culture, an understanding of what it takes to manage mutual funds and the ability to give Fidelity's managers and clients the support they need. We're interested to see what this new era for the firm brings.

Fund Mergers at Fidelity and Vanguard

This week we have news on mergers at both Fidelity and Vanguard. Fidelity’s move to combine two funds is fairly straightforward, while Vanguard's merger seems more advantageous for the firm than shareholders.

Fidelity Combining Two Europe Funds

On March 21, Fidelity plans to merge Europe Capital Appreciation and its Advisor-class clone into its Europe fund. Existing shareholders in Europe Capital Appreciation (which has been closed in anticipation of the merger) will have their shares converted automatically to shares of the Europe fund.

When you compare the two funds, the merger makes a lot of sense. To start, they are both managed by the same pair of co-managers, Risteard Hogan and Stefan Lindblad. When you look under the hoods of the portfolios, the similarities grow: They both fall into the large-cap category, and they have nearly identical top-10 holdings, sector allocations and performance over the last one-, three- and five-year periods. Europe Capital Appreciation charges slightly more in expenses, 1.09% vs. Europe's 1.06%, but otherwise, the two funds are more or less interchangeable.

It seems logical for Fidelity to streamline its fund lineup and combine the two funds' assets. Europe Capital Appreciation is the younger and smaller of the two funds, with $362 million to Europe's $1 billion, so it will end its run just over 20 years after its inception at the end of 1993.

While we feel regional funds like this are generally not the best choices for a diversified portfolio, we do not feel shareholders in either fund have much reason for concern at the merger.

Vanguard Merges Two Growth Funds

On February 24, Vanguard merged the assets of its Growth Equity fund into its U.S. Growth fund, also moving Growth Equity's two sub-advisers, Baillie Gifford and Jennison Associates, to U.S. Growth's management roster, where they join existing co-managers Delaware Investments, Wellington Management and William Blair and Co.

We first covered the proposed merger in our October 25, 2013 issue of the *Adviser Fund Update*, and our feeling on the maneuver hasn't changed in the intervening months. The newly reimagined U.S. Growth fund does not seem likely to benefit from the additional management teams. Under its new structure, it has the makings of a multi-managed, index-like mess.

Vanguard said the move was about "cleaning house" and simplifying its fund lineup. We would argue that to clean house, you need to actually throw some things away. By keeping Growth Equity's management teams, Vanguard has done the equivalent of sweeping the fund's poor performance track record under U.S. Growth’s rug. The mess is still there, you just can't see it—for now. Unfortunately for investors, U.S. Growth has not exactly had a stellar run of success either. We would steer clear of the fund.