ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

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Vanguard Under New Management

On March 3, Vanguard Chairman, President and CEO Jack Brennan, 53, passed the title of president to Frederick William McNabb III, 50, and will be handing over the CEO position to McNabb at some point in the next year. Brennan will stay on as chairman, but McNabb will be added to the Board of Directors.

McNabb has been with Vanguard for 22 years, and he has extensive experience running the firm's various institutional businesses. His position up until the end of February was Managing Director, with direct responsibility for Vanguard's Institutional and International businesses—the two of which account for about $700 billion in assets.

The move came as a surprise—it was announced just over a week before it took effect—and it left many in the industry somewhat puzzled. Brennan has said that his scaling back of responsibilities has nothing to do with his health (by all accounts he's in good shape, having been an avid jogger for years), but that this just seemed like a good time to pass the torch. It's hard to determine if there are other, hidden reasons for the changeover, but that said, we feel that there is absolutely no cause for alarm for Vanguard's shareholders. The transition should be seamless and investors should expect the same level of service they experienced while the firm was run by Brennan.

We also have a feeling that this is not a precursor to Brennan saying a final farewell to Vanguard and exiting stage right. As mentioned above, he will still remain involved with the company indefinitely as chairman of the board, while divesting himself of day-to-day responsibilities for the firm. Our sense is that he may try to establish himself as Vanguard's next public voice, supplanting the aging Jack Bogle, who has unofficially filled that role since his ouster over a decade ago. However, we'd expect that Brennan would toe the company line more closely, as opposed to Bogle's approach, which has been to both compliment and criticize (his public disapproval of the firm's growing ETF business, for example, was not received well by Vanguard). It will be interesting to watch it all play out, especially if Brennan and Bogle begin duking it out through media outlets.

Vanguard Trims and Dresses Funds

Grantham, Mayo, Van Otterloo, which manages some $150 billion in assets and is the home of renowned pessimist Jeremy Grantham, has been fired by Vanguard's board. The quantitative group had originally been brought into Vanguard to run a piece of Explorer in the spring of 2000 (they were also given a portion of Small Company Growth Annuity that fall), then were the founding managers of U.S. Value when it bowed in June 2000.

U.S. Value had a generally positive run, making its way into several of our client portfolios, but the fund began to lag in June 2007, and Vanguard handed half of its assets to AXA Rosenberg, managers of Market Neutral. As performance began to suffer and the long-term viability of the fund was cast into doubt, we traded out of U.S. Value in the fall for Vanguard's Dividend Growth fund, which we see as having better growth potential. Vanguard clearly lost faith in the fund's management as well, and GMO was shown the door at the end of February.

Replacing GMO on U.S. Value will be Vanguard's own quantitative equity team, which runs various portions of other Vanguard funds and has full responsibility for Strategic Equity, Strategic SmallCap Equity and a number of institutional, quantitative funds.

The Vanguard group is also absorbing most of the assets GMO managed at Explorer (this probably means a little bit of money is being spread around the other five managers that remain), and is taking on the assets GMO ran at the annuity.

We think that the changes should be a positive for U.S. Value, and they most certainly will be a positive for Explorer, which has been struggling under the yoke of a few too many management teams and the bloated portfolio it's resulted in over the past several years. This doesn't mean Explorer is a fund we'll be incorporating into our client portfolios any time soon, but it does mean that it looks a little better now than it did previously.

Another concern brought up by this firing is whether Vanguard is being accurate in its disclosures. Just three months ago, the firm stated in U.S. Value's annual report (dated September 2007, but published halfway through November) that keeping GMO on as a manager was "in the best interests of the fund and its shareholders." Either they forgot to add the qualifier "for the next three months," or they had a rather quick change of heart as to what was truly in shareholders' best interests.

More Vanguard Moves

Unlike Fidelity, Vanguard generally cycles through manager changes just once a year, and February is often the month when those moves are announced. In addition to the GMO firing, Vanguard has elected to add a third management team to International Growth from M&G Investment Management (they will also be handed a piece of International Annuity).

M&G has been running Precious Metals & Mining since its inception in 1984, and managers Graham French, who has been on the metals fund since 1996, and Greg Aldridge will be given responsibility for M&G's portions of International Growth and International Annuity.

We do not feel that the addition of M&G merits any trading into nor out of International Growth, which we hold in some client portfolios, but as always, we are wary of multi-managed funds. We'll be keeping a close eye on the fund and will make any moves as necessary.

Fidelity's Next International Fund
Fidelity has filed for a new international fund to be called Emerging Europe, Middle East, and Africa (EMEA). It seeks capital appreciation and will invest at least 80% of its assets in investments tied to the EMEA region.

Fidelity International has been running a version of this fund since late 2007, and while performance information is quite scant, taking a look at the portfolio, the fund has a little over 42% of assets in Emerging Europe (former Soviet Bloc, central, eastern and southeastern European countries are considered "Emerging Europe"), another 41% in Africa, about 7% in the UK and the remainder split between other European countries and the Middle East.

How close the U.S. version of the fund will stick to these allocations is as yet unknown, but it will be interesting to see how this slice of the international market, particularly with the heavy stake in African companies (which are not to be found with any significant allocation in most of the international funds we track), can distinguish itself from Fidelity's other international funds.

About Adviser Investments

Adviser Investments is an independent, professional money management firm specializing in Fidelity and Vanguard mutual funds. With 1,400 clients and $1.2 billion dollars under management, Adviser is one of the nation's largest mutual fund research and money management firms. Our staff of 35 investment professionals focuses on helping individual investors, trusts, foundations, and institutions meet their investment goals. Our minimum account size is $350,000.

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