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April 3, 2008

Vanguard's Global Gambit

On April 2nd, Vanguard announced that it had filed with the SEC to open a new fund, Global Stock Index, sometime in the second quarter of this year. The fund will fill a niche both in the firm's index line-up (its only global fund is the actively-managed Global Equity) and, more importantly, in Vanguard's ETF line-up (there will be institutional shares as well).

Global Stock Index will track an index from the firm's new favorite international series of indexes, the FTSE All-World Index. This should not be confused with the FTSE All-World ex-US Index, the benchmark for Vanguard's World ex-US Index—essentially the same index, minus any holdings in the United States (a sizeable portion of the wider index). FTSE All-World Index consists of a blend of large- and mid-cap stocks from countries around the world, holding more than 2,800 companies in 48 countries, with about 45% of assets invested in U.S. equities.

Global Stock Index, as mentioned above, will be available in investor, institutional, and ETF shares. The investor and institutional shares will have Vanguard's standard back-end load of 2% for shares sold within two months (a protective measure the firm has put in place for long-term investors on most international offerings), and will also charge 0.15% up front, similar to Emerging Markets Index's 0.5% and World ex-U.S.'s 0.25% front-end loads. Investor shares will have a \$3,000 minimum initial investment and are slated to charge 0.45% in fees. Institutional shares will require a \$5 million initial investment and a proposed 0.20% in expenses. The ETF expense ratio is estimated to be 0.25% and will also require investors to pay standard brokerage fees.

The timing of the announcement comes close on the heels of iShares' inception of a very similar ETF, the MSCI ACWI (All-Country World Index) Index, which has a comparable mandate and invests in the same markets Global Stock Index will be covering. While iShares may have hit the market first, Vanguard's ETF will offer the fee advantage, undercutting MSCI ACWI Index's 0.35% expense ratio by 10 basis points when it eventually opens to investors.

Vanguard's newest addition should be welcome to international ETF investors looking for a new, low-cost means to access the global market, but our feeling remains that the firm's superior international

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offerings will continue to be their actively-managed funds, such as Global Equity and International Explorer.

Fidelity Goes Long-Short

Fidelity recently filed for a new fund to be named 130/30 Large Cap Fund. The fund will employ a long-short strategy, with the value of the long positions minus the short positions to account for 100% of the fund's assets. That's where the "130/30" part of the fund's name comes in—it will normally invest 130% of assets in long positions and 30% in shorts, although these percentages may fluctuate. The fund's goal is long-term growth, and its mandate will permit investments in growth and value stocks as well as foreign and domestic large-cap companies.

You may recall that Vanguard adopted a long-short fund of its own a few months ago (Market Neutral) at the end of November 2007, which may have provided Fidelity with some impetus to offer a competing product, although the two have distinct takes on long-short strategy.

Market Neutral's objectives differ from 130/30 Large Cap's in that the Vanguard fund holds roughly equivalent long and short positions in companies it views as under- and over-valued, respectively, in an attempt to make the fund impervious to economic factors, with the sole risk coming from the managers' stock picking abilities. 130/30 Large Cap, with a majority of assets in long positions, is more of a bet on long-term growth in the stock market and will be more influenced by economic factors, with the 30% of assets in short positions as a hedge against market declines.

Fidelity's new offering seems to have been inspired by a product run by one of the firm's subdivisions, Pyramis Global Advisors, which has offered a Large Cap Core 130/30 product to its clients for about a year and a half. That portfolio's goal is to outperform the S&P 500 Index by about four percent over a market cycle, by investing in U.S. equities while remaining beta and sector neutral. It is also run in the multi-manager style that Fidelity has just begun to adopt on several of its funds. It does appear that Fidelity's 130/30 Large Cap fund will have a somewhat wider mandate than the Pyramis product, however, as it will permit overseas investments as well. We'll have more on this new fund as details become available.

Fidelity & Vanguard Manager Changes

None of the following changes should be causes for concern for the funds' investors.

Fidelity's Moves

As of April 1st, Joanna Bewick began co-managing Strategic Income (its Advisor and VIP clones as well), Strategic Dividend & Income (Advisor shares too) and Strategic Real Return (Advisor shares as well) with Derek L. Young. She's been with the firm since 1997, starting out as a research analyst in the Fixed-Income Division, moving over to Fidelity Management Trust Company in 2000 as a senior vice president and senior investment analyst, leading a team that tweaked institutional portfolios. She briefly left Fidelity in 2006 to work with JP Morgan Asset Management as a vice president and fixed-income analyst following the financial sector, but came back to the Fidelity fold in October 2007 to work in the Global Asset Allocation Group.

William W. Irving has had his already hefty workload expanded to

include management of Mortgage Securities (its Advisor clone as well) and Intermediate Government Income, succeeding Brett Kozlowski. Irving will continue to manage Government Income (Advisor shares also), Ginnie Mae, Inflation Protected Bond (Advisor shares as well), Spartan Short-Term Treasury Bond Index, Spartan Intermediate Treasury Bond Index and Spartan Long-Term Treasury Bond Index. Irving has been with Fidelity since 1999, getting his start as a quantitative analyst for the Fixed-Income Division, and began managing taxable bond funds in 2004. Prior to joining the firm, he was a member of the technical staff at MIT Lincoln Laboratory and later Alphatech from 1987 to 1999.

Jess Tan has taken over Southeast Asia (fund), succeeding Allan Liu, who will continue managing equity portfolios for non-U.S. investors. Tan has been with Fidelity since 2000, starting out as a research analyst covering the Asia-Pacific region, researching various segments of that market up until 2002, when she began managing Asia-Pacific funds for non-U.S. investors. She's previously worked with American International Group as a fund manager and got her start in investment management as an equity research analyst with HLG Securities in 1994.

Colin Stone has been added as co-manager to International Small Cap, where he joins the current team of Wilson Wong and Tokuya Sano. Stone replaces Ben Paton, and will be responsible for the fund's European and non-Asian investments. Stone will also continue to manage several European funds available only to overseas investors, which he's been doing in one form or another since 1990. He's been with Fidelity since 1987, where he got his start doing equity research out of the firm's London office, and variously followed European companies, managed overseas funds and acted as director of investment management. Stone previously managed the Nordic fund from 1995 through 1998, and prior to joining Fidelity was an offshore petroleum engineer for Britoil from 1984 to 1986.

Vanguard's Moves

As of March 28th, Vanguard shifted around several managers on tax-exempt funds and money markets.

Marlin G. Brown has taken over Pennsylvania Long-Term Tax-Exempt, Ohio Long-Term Tax-Exempt and Massachusetts Tax-Exempt, replacing John M. Carbone, who will continue to manage Insured Long-Term Tax-Exempt and New Jersey Long-Term Tax-Exempt. Brown will continue to manage Limited-Term Tax-Exempt as well.

Kathryn T. Allen has replaced Brown on New Jersey Tax-Exempt Money Market and will continue to manage California Tax-Exempt Money Market, New York Tax-Exempt Money Market and Pennsylvania Tax-Exempt Money Market.

Pamela W. Tynan replaces Brown on Ohio Tax-Exempt Money Market and she will continue to manage Tax-Exempt Money Market and Short-Term Tax-Exempt.

Vanguard has labeled all of the moves a part of their occasional rotation of long-term managers, while also offering new responsibilities to other members of the team. They see the changes as a way to expand their managers' knowledge, strengthening the depth of the management team, which brings to mind Fidelity's internal manager grooming process.

Managed Payouts Planted

Vanguard's Managed Payout funds are finally here (almost). Vanguard says they'll begin a subscription period to build up cash between April 21 and May 4, then invest the money on May 5. However, Vanguard still won't identify who the members of the "investment committee" that will make all asset allocation decisions for the fund are.

We do know that Michael Buek, a veteran member of Vanguard's Quantitative Equity Group responsible for a number of index funds, has been named manager, but Vanguard's lack of disclosure about the investment committee leaves much about how the funds will be composed and run a mystery.

For more on the Managed Payout funds, please take a look at the October 5, 2007 edition of the Adviser Update, which you can find in our archives: <http://www.adviserinvestments.com/research/fund-updates>.

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