ADVISER INVESTMENTS

ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

June 8, 2012

Fidelity's Quest for Income Solutions

With bond yields touching historic lows and dividend yields averaging around 2% in the U.S., income-starved investors have been searching high and low for any investment that can deliver a decent yield. So it may come as no surprise to learn that Fidelity, in an effort to satisfy investors' growing appetite for income-producing investments, recently served up the Global Equity Income fund.

In recent years, yields on the top dividend-paying international stocks have averaged close to 5%, a rate that is more than double the yield on the S&P 500 Index. Therefore, from an income-generating standpoint, the rationale for a global equity fund makes sense.

Similar to its domestic counterpart (Equity-Income), Fidelity's new fund will invest at least 80% of its assets in income-producing equity securities. But rather than fishing primarily within U.S. waters, this fund will cast a wider net to encompass the entire universe of dividend-paying stocks. The fund manager also has the leeway to invest in non-dividend-paying stocks, as well as bonds. Using this mix of investments, the goal is to deliver an overall yield that exceeds the MSCI ACWI (All Country World Index).

Equity income funds as a whole tend to be less volatile than funds that invest in non-dividend paying stocks, as the companies in which they invest have more predictable, steadier cash flows and battleship-quality balance sheets. For that reason, equity income funds have typically appealed to older investors who need to generate income while also preserving their capital. Some of these same investors, many of whom are near retirement age or already retired, have been scarred by the extreme market volatility of recent years. Therefore, a global equity income fund that can deliver an attractive yield with the potential for lower volatility could draw substantial interest.

Global Equity Income may also provide investors with greater diversification than a U.S.-focused fund. That's because international dividend-paying stocks can be found in many sectors

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and geographic regions. In many cultures, investors demand--and receive--higher dividend payments. In some countries, it's required by law. For example, Brazil requires companies to pay out 25% of earnings to shareholders. Conversely, in the U.S., stocks with high dividend yields are found primarily within the utilities, telecommunications and consumer staples sectors. These traditionally defensive sectors usually lag the overall stock market during market rallies but decline less during selloffs.

Ramona Persaud, a nine-year veteran of Fidelity, will serve as Global Equity Income's portfolio manager. She has been co-manager of Equity-Income since last October. Previously, she was an assistant portfolio manager on Diversified International from 2008 to 2011. She managed Select Banking from 2006 to 2008 and Select Construction and Housing Portfolio from 2004 to 2006. Persaud began her career at Fidelity in 2003 as a research analyst and covered the banking, housing, packaging and radio frequency industries.

Global Equity Income has an initial investment minimum of $2,500 and Fidelity has capped the fund's expense ratio at 1.20% through 2013. Currently, the uncapped expense ratio is on the high side at 1.58%, but we expect that will come down as the fund starts to attract assets. The fund also carries a 1% short-term redemption fee for shares sold within 30 days of purchase.

Given the relatively low dividend yields in the U.S. and the paltry yields available from bonds, the case for a global equity income fund has some merit. In fact, given that other global equity income funds have been around for several years already, it's somewhat surprising that Fidelity did not launch a fund like this earlier. It's too soon to tell whether Persaud and her support staff have the skills and judgment necessary to succeed with this new fund. But we will be following this fund closely to see if it proves to be viable for our clients' portfolios.

Vanguard Closes High-Yield Corporate to New Investors

Vanguard recently announced it has closed High-Yield Corporate bond fund to all new investors. Only those with "Flagship" status ($1 million or more in Vanguard assets) or those who pay Vanguard a management fee through its Asset Management service will be able to make additional purchases.

High-Yield Corporate is one of the more conservative "junk" bond offerings in the mutual fund marketplace and has generated strong long-term returns. As of June 7, the SEC yield was 5.92%, a fair bit higher than Long-Term Treasury, for instance, which had a 2.15% yield.

As is often the case with outperforming funds, High-Yield Corporate became a victim of its own success. The fund attracted about $2 billion in new money over the past six months alone, as investors continued to seek investments that can deliver higher yields than what's available from more conservative fixed-income funds. In fact, it appears that many investors also moved out of lower-yielding funds, like Vanguard's Short-Term Treasury, Short-Term Federal, Intermediate-Term Treasury and Long-Term Treasury funds, as these funds experienced net outflows of almost $500 million over the same period.

Investors who don't already own shares in High-Yield Corporate may not have to wait too long, however, for the doors to reopen. The last time Vanguard closed the fund was in June 2003. Soon thereafter, investors began moving money out of the fund. After a net $600 million left the fund, Vanguard reopened it in Dec. 2003. This time around, however, it's unlikely we will see net outflows until we see a significant turnaround in the bond market.

About Adviser Investments

Adviser Investments and its subsidiaries operate as an independent, professional money management firm with particular expertise in Fidelity and Vanguard mutual funds. With 2,400 clients and over $2 billion under management, Adviser Investments is one of the nation's largest mutual fund research and money management firms. Our investment professionals focus on helping individual investors, trusts, foundations, and institutions meet their investment goals. Our minimum account size is $350,000.

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