ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

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In This Issue

Fidelity's 529 Plans

Over the last three updates, we covered the basics of 529 plans, financial aid and state tax benefits as well as a review of several plans that stood out to us. As we closed out the series, we got a few questions from readers about the four plans run by Fidelity (Arizona, Delaware, Massachusetts and New Hampshire) and how they stand up to the competition, which we've tried to answer below.

In the most recent issue of the *Adviser Fund Update*, the four plans we reviewed had a couple of strong factors going for them individually and overall: A wide variety of choices and low expenses, whether they were based on actively managed or index funds. Fidelity's 529 plans do offer a decent variety of choices among pre-built portfolios and a level of customization, but the expenses are higher than the plans we looked at for the most part, and there are other issues to be aware of as well.

Fidelity offers the same choices between active and index age-based tracks and static portfolios to all four state plans it manages. Arizona is a tax parity state, so residents can get the state tax benefits no matter which state plan they invest in. Delaware, Massachusetts and New Hampshire offer no tax breaks to 529 investors, so unless investing in Fidelity funds is a high priority, there is no additional benefit to choosing those states' plans for residents.

Looking at the underlying Fidelity and outside firm funds offered in the four plans, some of Fidelity's better managers and funds are included in the actively-managed portfolios, and there are some interesting third-party choices as well. If you were able to create a fully customized portfolio out of the underlying options, Fidelity's plans would be a great option—but you can't. Unfortunately, the firm has overly diversified the actively-managed portfolios.

What do we mean by overly diversified? In the age-based tracks, the portfolios using Fidelity actively managed funds are made up of 26 funds (eight of which are large-cap funds), and the multi-firm portfolios include a whopping 32 funds! Allocating among this many funds and managers defeats the purpose of active management, since any one manager's contribution to the portfolio's overall return will be minimal, and you'll end up with thousands of underlying stocks, basically giving you an overpriced index fund. The static options are marginally better, but they still are fairly bloated, with significant overlap within asset classes. The index fund portfolios (age-based and static) are much more streamlined, including at most five funds, but as mentioned earlier, they are more expensive than the Vanguard plans we reviewed, with annual fees between 0.31% and 0.35%, whereas the most expensive Vanguard plan we looked at charged 0.25% across the board for all portfolios.

Finally, if you take Fidelity up on its customization option, you can choose among five index funds, cash, the age-based portfolios and the static portfolios (active and index). If you allocated among two or more of the static and/or age-based actively managed portfolios, you'd have the potential to not only be allocating twice to the same managers, but also to include nearly 60 managers in your portfolio overall, again creating an expensive index fund.

None of this is to say that one couldn't effectively use one of Fidelity's 529 plans to help pay for a beneficiary's college expenses. But you should know what you're getting into before investing in them.

Vanguard Shuts the Door on Florida

Without much fanfare, Vanguard merged its Florida Focused Long-Term Tax-Exempt fund into the Long-Term Tax-Exempt fund and out of existence just before month's end after shareholders approved the plan earlier in July.

Once the Sunshine State did away with its intangible personal property tax in 2007, there was little reason left for Vanguard's Florida fund to stay in operation, as its sole purpose was to protect gains from that state-specific tax. However, Vanguard kept the fund running. Investors weren't harmed by the lack of the tax benefit, as it was still exempt from federal taxes and returns were very similar to the broader, national municipal Long-Term Tax-Exempt fund, but we began to wonder just how much longer the fund would stick around.

In March of this year, after six years, Vanguard finally took action, closing Florida Focused Long-Term Tax-Exempt to new investors and setting up a vote for shareholders to determine the fund's fate. As mentioned above, more voted "yay" than "nay" and the fund ended its 21-year run.

If you were an investor in the fund and this news has taken you by surprise, we don't think there is any reason for alarm. Your shares have been converted into shares of Long-Term Tax-Exempt automatically and you will be receiving the same federal tax benefits as before (you may want to pay closer attention to your monthly income from the new fund at first to make sure it's still meeting your needs, however). And as we mentioned above, the performance and risk profiles of the two funds were very alike. So while it's the end of an era for Vanguard and Floridians, the reasoning behind the fund merger was logical and not to investors' detriment.

About Adviser Investments
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