



## ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments



October 25, 2013

### Vanguard Tidies Fund Offerings

On Oct. 16, Vanguard announced plans to streamline its offerings through a series of mergers to remove redundancies and wipe a couple of underwhelming funds out of existence.

Vanguard CEO Bill McNabb took a cue from *Walden* in describing the firm's motivation: "Over the past five years, we have moved to simplify our funds and our overall fund lineup," McNabb said. "In continuation of that effort, we have decided to merge a handful of funds that have similar objectives and strategies."

The \$3 billion Tax-Managed Growth and Income fund is getting tucked into the \$143 billion 500 Index fund. Both funds track the S&P 500 index, and while Tax-Managed Growth was marketed as being a tax efficient means of tracking the index by not paying capital gains, 500 Index hasn't paid out any capital gains of its own in the last 10 years, making the Tax-Managed fund superfluous. Regardless, if taxes are a concern, investors will likely opt for an ETF, which are more tax efficient than mutual funds by nature.

The same rationale applies to the \$16.3 billion Developed Markets Index fund, which is going to be merged into the \$18.4 billion Tax-Managed International fund (which will in turn take the Developed Markets Index name); both are benchmarked against the FTSE Developed ex-North America index.

Vanguard is also implicitly acknowledging the failure of its Managed Payout series of three funds, which all shared the goal of making steady distributions to shareholders on a monthly basis with varying capital appreciation and income goals. On the whole, the funds have not been able to meet their objectives and have had to dip into investors' principal to make the monthly payments. Vanguard is merging the Managed Payout Growth and Managed Payout Distribution Focus funds into Managed Payout Growth & Distribution (the most balanced option of the three). The fund will be renamed Vanguard Managed Payout—it will have the goal of outpacing inflation by 4%, which is an easier goal than Managed Payout Growth & Distribution's original 5% target. We remain doubtful of the condensed, new fund's potential.

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Finally, the \$738 million Growth Equity fund is being merged into the \$4.4 billion U.S. Growth. Vanguard has replaced both funds' managers in the past five years, and the combination seems like another attempt to breathe some new life into the large-cap growth funds. The missteps of Growth Equity's original manager, Turner Investments, plagued the fund for years. In 2008 and 2009, Baillie Gifford and Jennison Associates were brought in to right the ship. At U.S. Growth, AllianceBernstein was shown the door in fall 2010, when Delaware Investments and Wellington Management joined existing manager William Blair & Co. on the fund. The new version of U.S. Growth will keep all five management teams on board, and seems like a recipe for a bloated, index-like portfolio.

### **Vanguard Cuts Costs**

Also on Oct. 16, Vanguard opened Admiral Shares to a much wider pool of investors, including individuals, financial advisers and institutional investors. Vanguard lowered the minimum investment amounts and expanded access for most retail investors, and got rid of minimums and tenure requirements for financial advisers and institutions.

Admiral shares originated in 2000 as a way for Vanguard to pass along cost savings associated with large and long-tenured accounts to shareholders through lower expense ratios. As of this month, Admiral shares are available for 83 Vanguard funds, including 49 index funds, some of which carry expense ratios as low as 0.05%.

What prompted this change? It's all part of a larger plan to gradually phase out Vanguard's higher-minimum Signal share class. With ETFs gaining market share and bringing costs lower across the industry, Vanguard has demonstrated that it intends to keep pace, which should benefit investors in the end.

### **Next Time: Fidelity's New Business**

In the next *Adviser Fund Update*, we'll look at Fidelity's lineup of 10 single-industry ETFs, which launched on Oct. 24. The ETFs will be in direct competition with very similar offerings from Vanguard, and represent just the latest volley in the ongoing fee war between the two firms.

### **About Adviser Investments**

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