ADVISER INVESTMENTS

ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

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## Does the Benchmark Make a Difference?

In our September 15 *Adviser Fund Update*, we covered Vanguard's launch of a slew of ETFs tracking a bevy of S&P and Russell indexes and sub-indexes. Since then, we've taken a look at the various indexes side-by-side to see what, if any, differences could be found among them. When all is said and done, there are more similarities than differences between the S&P and Russell indexes these new ETFs track, and the MSCI indexes Vanguard has been using for years now, with a few notable exceptions.

In the case of the large-cap S&P and Russell ETFs, the new bogeys represent indexes that use both more (the Russell 1000) and fewer (the S&P 500) stocks than the MSCI Prime Market 750. Similarly, Vanguard has straddled its existing small-cap MSCI ETFs with one index (Russell 2000) that contains more stocks, as well as one (S&P SmallCap 600) that contains less. In the mid-cap space, the new S&P MidCap 400 index is slightly smaller than the existing MSCI MidCap 450 (Vanguard isn't launching any Russell mid-cap ETFs).

On the quality side of the ledger, the S&P indexes represent companies that pass a more stringent quality screen than their Russell or MSCI peers. This could be one reason that the S&P growth sub-indexes have outperformed their peers by losing less in downturns.

From a risk-return standpoint, each of the various ETF bogeys has its pluses and minuses, depending on where you're allocating your monies.

| Risks and Returns Over the Decade – Large-Caps | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | S&P 500 | Russell 1000 | MSCI 750 | S&P Gro. | Russell Gro. | MSCI Gro. | S&P Val. | Russell Val. | MSCI Val. |
| 10-year return | -0.40% | -0.20% | -0.40% | -2.90% | -3.40% | -3.60% | 1.60% | 2.60% | 3.20% |
| Maximum Cumulative Loss | | | | | | | | | |
| 2000-2002 Tech Crash | -44.70% | -45.10% | -46.70% | -57.80% | -61.90% | -64.60% | -32.20% | -27.70% | -26.50% |
| 2008 Financial Crash | -51.00% | -51.10% | -50.50% | -56.70% | -60.80% | -62.20% | -56.80% | -55.60% | -54.90% |
| Sources: Data courtesy of S&P, Russell, MSCI; calculations by Adviser Investments. 10-year returns through September 2010. | | | | | | | | | |

The table above shows not only the 10-year returns for the various large-cap indexes and sub-indexes through August 2010, but also the losses suffered during the two major market disruptions of the decade: the 2000–2002 tech crash and the 2008 financial meltdown.

Among the large-cap indexes there are small but fairly minor differences. MSCI's large-cap growth index was clearly the riskiest of the three during both market upheavals, while S&P's value index suffered mightily compared to its peers.

In contrast, the dispersion of both returns and risks is greater among the small-cap indexes, as indicated in the table below. In particular, note that S&P's small-cap growth index held up substantially better than its peers during the tech tumult but was more in line with the MSCI and Russell indexes during the financial crash. Is it any wonder, then, that the S&P small-cap growth index's 10-year return of 5.6% is substantially higher than those of its MSCI and Russell peers, up 2.0% and down 0.1%, respectively?

| Risks and Returns Over the Decade – Small-Caps | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | S&P 600 | Russell 2000 | MSCI 1750 | S&P Gro. | Russell Gro. | MSCI Gro. | S&P Val. | Russell Val. | MSCI Val. |
| 10-year return | 6.20% | 4.00% | 5.60% | 5.60% | -0.10% | 2.00% | 6.60% | 7.70% | 8.90% |
| Maximum Cumulative Loss | | | | | | | | | |
| 2000-2002 Tech Crash | -27.40% | -35.00% | -26.70% | -27.00% | -62.60% | -54.00% | -28.10% | -26.70% | -22.30% |
| 2008 Financial Crash | -52.20% | -52.90% | -54.00% | -51.60% | -56.00% | -53.60% | -54.20% | -55.50% | -56.10% |
| Sources: Data courtesy of S&P, Russell, MSCI; calculations by Adviser Investments. 10-year returns through September 2010. | | | | | | | | | |

Longer-term performance comparisons suggest that the similarities between these various indexes outweigh their differences. That said, investors looking to use a growth-oriented sub-index will probably be best advised to stick with the S&P ETFs whether focused on large-caps or small-caps. By contrast, the S&P ETFs are best avoided in the value space, with MSCI's value indexes the best overall performers.

The bottom line in all of this is that the introduction of this new slate of ETFs is a shrewd marketing move to further gain the upper hand in the ETF marketplace. Vanguard is already a low-cost leader in traditional indexing. Now, with operating expense ratios that undercut iShares, the ETF industry leader, Vanguard is set to lead, rather than follow.

As if to underscore the fact that these new index ETFs have no real advantages over their older siblings, Vanguard's website has been directing investors interested in the new ETFs to their MSCI counterparts, noting that expenses are lower. These suggestions will likely disappear over time. Also, a report issued by Vanguard earlier this year comparing the various index providers concluded, after much hemming and hawing, that there really is very little difference between the Russell, the S&P and the MSCI indexes over time.

For these reasons, our opinion is that investors in Vanguard's MSCI-index-based ETFs don't need to make any dramatic changes to their portfolios as a result of this introduction.

**Manager Changes**

Fidelity and Vanguard both announced manager changes in the last couple of weeks. In both cases, the changes should be no cause for action by investors in the affected funds.

Effective November 1, Michael Chren will be taking over Fidelity Blue Chip Value, Advisor Value Leaders, and VIP Value Leaders, succeeding Charles W. Hebard. Chren will continue to co-manage Series Large Cap Value (an internal-use-only fund, not available to individual investors). Prior to joining Fidelity in 2009, Chren served as senior managing director and senior portfolio manager for Allegiant Asset Management Group, where he was team leader of the Large Cap Value division and responsible for managing both mutual fund and individual institutional accounts. Prior to that, he was a partner and senior portfolio manager for Invesco Capital Management, and he has also been a portfolio manager for Deprince, Race and Zollo, and a senior vice president and portfolio manager for Eagle Asset Management. Chren's curriculum vitae also includes stints at Bear Stearns, Raymond James, Junction Advisors and Mabon Securities, dating back to 1986. It's hard to tell if Chren will be an upgrade over Hebard, as this is Chren's first open-end fund management assignment, but looking back to our Chief Investment Strategist Jim Lowell's proprietary manager ranking system results through June, we see Hebard ranked 21st out of 30 Fidelity growth and growth and income managers, a less-than-inspiring result.

Over at Vanguard, there has been a small change in the management teams running PRIMECAP's three Vanguard funds as David Van Slooten is leaving and being replaced by PRIMECAP's head of research, Mohsin Ansari. As you may know from past updates, we are big fans of the PRIMECAP Management team, but this move is no cause for concern, as Ansari is no rookie to investing in the PRIMECAP style. As of the announcement, Ansari was already running $1 billion for PRIMECAP, and, as the head of research, he probably knows more about PRIMECAP's growth-at-a-reasonable-price investment strategy than almost anyone else at the firm other than the founders and existing portfolio managers. The change doesn't affect the

PRIMECAP Odyssey funds, which we've been favoring in more recent years, because Van Slooten had no role there.

## About Adviser Investments

Adviser Investments is an independent, professional money management firm specializing in Fidelity and Vanguard mutual funds. With 1,500 clients and over $1 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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