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### **Fidelity's Musical Chair Managers and Vanguard's Overseas Additions**

Fidelity and Vanguard both went looking for yield over the past couple of weeks, with Fidelity staying close to home and Vanguard venturing for the first time into foreign bond markets. The process included management changes as well.

At Fidelity a veteran manager is leaving both Equity-Income and Equity-Income II, which is concurrent to (and perhaps a result of) both funds reemphasizing the income component in their basic mandates. A minor change at International Small Cap was also announced. None of the changes should be of particular concern to current investors, although those who hold the Equity-Income funds may want to review the new objectives to see if the funds still match their investment goals.

Meanwhile, the rising interest in international investments combined with investors' desire to generate income during a volatile period in the stock market has prompted to Vanguard to create two new foreign bond funds to fill a gaping hole in its fund roster while meeting investor demands. Many of Vanguard's competitors offer foreign bond funds, so it was only a matter of time before the firm stepped into the market.

For more detail on all of these items, please read on.

### **Fidelity Changes Mandates, Managers at Equity-Income Funds**

Fidelity has shaken up management at Equity-Income and Equity-Income II, two of its conservative large value funds. In both cases, Stephen Petersen, who managed Equity-Income for more than 18 years and Equity-Income II since 2009, has been replaced.

Effective October 26, a team comprised of James Morrow, Adam Kramer and Ramona Persaud took the reins of the \$7.3 billion Equity-Income. Morrow will serve as lead manager, Kramer will manage the fund's high-yield bond and convertible securities holdings and Persaud will focus on global equities. At Equity-Income II, which has \$4.2 billion in assets, veteran manager Scott Offen has assumed management duties.

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Of greater importance to current investors--and likely what prompted the leadership change--Fidelity has revamped each fund's approach to focus more on securities that can deliver higher dividend yields. More emphasis will also be given to each fund's bond and convertible securities holdings. These adjustments are designed to better meet the changing needs and preferences of aging Baby Boomers, many of whom are seeking funds that can deliver higher income and less volatility. Under Petersen, both funds tended to stress capital appreciation opportunities over income.

While in the past Equity-Income II was more aggressive than Equity-Income, those roles have now been reversed. Both funds will seek current yields that are approximately 25% to 50% higher than the yield on the S&P 500. However, Equity-Income II will now be more focused on income and will invest fewer assets in foreign securities than Equity-Income.

Equity-Income lead manager James Morrow joined Fidelity as an equity research analyst in 1999. Like most of Fidelity's homegrown talent, he earned his stripes by managing several sector funds, including Select Business Services and Outsourcing, Select Electronics, Select Computers, Select IT Services and Select Technology. In 2006, he landed his first diversified fund assignment at Advisor Diversified Stock. Earlier this year, he was named co-manager at Advisor Equity Income and VIP Equity-Income.

Adam Kramer began his career at Fidelity in 2000 as a research analyst. He has covered the healthcare, energy, automotive, aerospace/defense and lodging industries, among others. He has managed the convertible securities sub-portfolio for Strategic Dividend and Income since 2007 and a sub-portfolio of preferred stock since 2010. Along with Morrow, he has co-managed Advisor Equity Income Fund and VIP Equity-Income Portfolio since April 2011.

Persaud joined Fidelity in 2003 as a research analyst and managed Fidelity Select Construction and Housing from 2004 until 2006 and Select Banking until 2008.

Equity-Income II manager Scott Offen has been with Fidelity for more than 26 years, having joined the firm in 1985. In addition to previously managing the requisite list of sector funds, he has managed Value Discovery since 2002 and was named manager of Advisor Equity Value in 2006. He has also served as co-manager of Strategic Dividend and Income since 2006 and VIP Value since 2010.

#### **Fidelity Names Price Co-Manager of International Small Cap**

Fidelity also made a change at International Small Cap, naming Nicholas Price as co-manager in place of Noriko Takahashi. Price, who will manage the fund's Japanese holdings, will work alongside co-managers Colin Stone and Dale Nicholls. He will also continue to manage Japan Smaller Companies, which he has led since 2008. Price joined Fidelity as a research analyst in 1993.

#### **Vanguard Broadening Its International Bond Index Lineup**

Last February, we speculated that Vanguard was on the verge of introducing some international bond index funds for U.S. investors (the firm already runs several for overseas investors). While it took longer than anticipated, Total International Bond Index and Emerging Markets Government Bond Index will launch in early 2012.

Despite previously-voiced concerns about U.S. investors' ability to tolerate foreign currency fluctuations, Vanguard recognized that it needed to add some foreign bond offerings to remain competitive. Total International Bond Index will benchmark its performance against the Barclays Global Aggregate ex-USD Float Adjusted Index (Hedged). To help neutralize the impact of currency fluctuations, the fund will use a hedging strategy. Emerging Markets Government Bond Index will use the Barclay's Emerging Markets Sovereign Index (USD) as its benchmark. This fund will only invest in dollar-denominated emerging market government debt, which eliminates currency risk (although other types of risk are still present, as you'll see below).

Of the two funds, the emerging markets bond index offers a greater opportunity to diversify portfolios, but with more potential volatility. The maximum cumulative loss (MCL) we calculated on the benchmark underlying Total International Bond Index, at -6.3% , isn't much different than Total Bond Market's -5.8% reading. But the emerging markets index's MCL of -34.5% puts bond risk in a whole new light.

Gregory Davis, CFA, is the head of Vanguard's Bond Index Group and will manage Total International Bond Index. Davis has been with Vanguard since 1999, and manages a slew of the firm's fixed-income index portfolios, including Total Bond Market Annuity, the seven bond index funds and exchange-traded funds (ETFs) introduced in November 2009 and the bond portion of the soon-to-eliminated Asset Allocation fund.

Yan Pu, CFA, who's been in investment management since 2000 and co-manages two international bond funds for non-U.S. investors with Davis, will manage Emerging Markets Government Bond Index.

Both funds will have initial investment minimums of \$3,000 and Vanguard expects to offer lower cost Admiral Shares and ETF Shares for both funds. The funds' estimated expense ratios are as follows:

<b>Share class</b>	<b>Total International Bond Index</b>	<b>Emerging Markets Government Bond Index</b>
Investor	0.40%	0.50%
Admiral	0.30%	0.35%
ETF	0.30%	0.35%

Source: The Vanguard Group

In addition, Total International Bond Index will carry a 0.25% front-end load, while Emerging Markets Government Bond Index will charge 0.75% for the purchase of new shares. There will be no loads on the ETF shares.

The new funds are an interesting and, from a market-share standpoint, likely necessary additions to Vanguard's fund lineup. As we have held international bond funds in some client portfolios in the past and view the global bond market as a growing opportunity for diversification, we'll be keeping a close eye on these two funds after they debut.

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