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MUTUAL FUNDS: WHY NO LOADS AND LOW COSTS MATTER

by Stewart Farnell, Ph.D., CFP®, Boulder, CO

Many investors are long-time believers in no-load mutual funds, which can be bought without paying a sales commission, or "load."

A study published in the May 2003 issue of *Financial Planning* magazine confirms the wisdom of avoiding sales charges. Dr. Craig Israelsen of the University of Missouri examined load and no-load funds that invested at least 80% of their assets in U.S. stocks from 2000 to 2002.

Israelsen concluded, "No-load funds uniformly outperformed load funds." That is, they had a higher total return after expenses. In fact, no-load funds outperformed the load funds in every one of Morningstar's style categories of stocks. In some cases, the difference in performance was huge. In the small-cap growth category, the no-load funds beat the load funds by an average of 4.3% per year. The importance of this becomes apparent when we recall that the average return of small company stocks historically has been about 11% per year. In other categories, the outperformance was almost insignificant. For example, in the mid-cap value category, the no-load funds beat the load funds by only a tenth of a percentage point per year. But in every case, the no-load funds came out ahead.

One factor that contributes to the superiority of no-load funds is their lower expenses. This is not a sales commission, but rather the fund's ongoing charge for managing the money invested. In Israelsen's study, on average, the no-load funds had lower annual expenses of 0.37% per year ($370 per $100,000 invested) than their load fund competitors. This observation confirms another belief about fund performance: fund expenses matter.

The investors who buy the shares, not the company that oversees the fund, pay the expenses of running a mutual fund. The "expense ratio," expressed as a percentage, varies widely from fund to fund. Some funds (including some no-load funds) charge investors between 2% and 3% of the fund's assets a year (between $2,000 and $3,000 per year per $100,000 invested). Others charge investors 0.2% per year ($200 per year per $100,000 invested) or less. This difference—paying $200 per year versus $2,000 per year—is obviously enormous. When compounded over decades, the lower fees can make the difference between a successful investment program and an unsuccessful one.

> "Successful investing involves more than just avoiding sales commissions and excessive fund expenses. Using no-load funds with low expenses will provide a significant advantage in reaching your financial goals."

Of course successful investing involves more than just avoiding sales commissions and excessive fund expenses. But other factors being equal, using no-load funds with low expenses will provide a significant advantage in reaching your financial goals. ■ ■ ■

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PREPARING FOR THE INEVITABLE

by Kathleen M. Rehl, Ph.D., CFP®, Land O'Lakes, FL

My soulmate and husband, Tom, died in February 2007. Then my dear mother passed away a month later.

Although I miss their physical presence tremendously, their spirits and love will always be with me. I'm grateful for my faith, along with the friends, family, and clients who offered their loving support.

Yes, managing grief at the death of a loved one is difficult. You may have experienced a similar intense heartache yourself.

In my case, there were two estates to settle. That's pretty straightforward work, although it is time consuming. Tom and my mother did almost everything right in terms of their end-of-life planning, thanks in part to their astute financial advisor.

Think of it this way. Having all in order is the last gift you can give those you leave behind. What a wonderful bequest for your loved ones! Think of it as tying up the loose ends of our lives. If left undone, incomplete estate plans may cause pain, guilt, sorrow, and regret for family members, on top of the grief they feel.

My husband's and my mother's IRAs and other retirement plan beneficiaries were identified correctly. Tom's and Mom's wills were current. Annuity and life insurance beneficiaries were up to date. And their nonretirement accounts were "payable on death" or "transferable on death" to avoid probate. They both had updated their living wills, so there was no question about their wishes when they were near the end of their lives.

It's been said that half of all lawyers die without wills. That's understandable. Preparing for your own death demands you confront a toxic mix of chaotic emotions and enervating details. I'm glad that Tom's and Mom's updated documents were in place well before their deaths.

Still, I had to make dozens of decisions, especially with Mom's estate. She wanted everything split equally among her three children, but what does that really mean in terms of the family mementos that were in her apartment? My brothers and I amicably divided those sentimental items. We donated much of her household furnishings to help needy families through Lutheran Services of Florida. I ended up taking some things none of us really wanted but that I couldn't bear to let leave the family (like the small well-worn green stool my great-great-grandfather made for Mom when she was a little girl).

So, as you think about your own end-of-life plans, what loose ends do you need to tie up?

1. Check your beneficiary statements.

Retirement accounts like IRAs, 403(b)s, 401(k)s, and pension plans, along with insurance policies and annuities, pass to your designated beneficiaries outside of the probate process. If you haven't checked your beneficiary listings lately, request a current record to verify that your listings match your intentions. Don't forget to identify any charities in your list of beneficiaries. Remember that in certain states, you can also transfer your residence with a Lady Bird Deed (which conveys an enhanced life estate). Keep a listing of all these beneficiaries where they can easily be found, probably close to where you keep your will.

2. Revisit your will.

Find your will and let other people know where it is—no hide and seek games, please. Read your will. Does it do what you want it to do? Do you understand what's in it? If not, see your lawyer. (The same suggestion goes for your living trust if you also have one.)

3. Have your advance health care directives in place, including a living will.

If appropriate, you may also want your physician to prepare a DNR (do not resuscitate) order.

4. Identify who gets which special keepsakes.

If you want distinctive treasures to go to special people, put it in writing. It doesn't have to be complicated, but it does have to be clear. This is sometimes referred to as a "separate letter of instruction" about your personal items. If you think there might be disagreement, include this in your will to make it enforceable by the probate court. The workbook *Who Gets Grandma's Yellow Pie Plate?* (published by the University of Minnesota Extension Service) may be helpful.

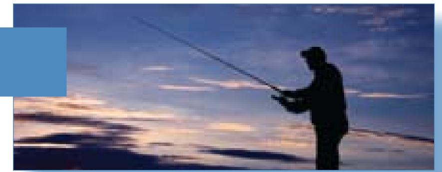
5. Decide what you want for your funeral or memorial service and let your family know.

Tom actually wrote much of his memorial service (he was a pastor). You can simply let others know if you want to be cremated or buried. What favorite sacred verses or music would you like included? Who should be notified? Planning in advance will help your family during that difficult time.

6. Tell people you love them—TODAY.

Remember that you too will die someday. We're all guaranteed to have that experience. Waiting until then will be too late to say you're sorry and make up. Let the healing begin while you are still alive.

Yes, when your time comes to leave this earthly life behind, your loved ones will feel a greater sense of comfort because of your thoughtful actions before your death. Do what you can now to help those you care for in the time ahead when you, too, will pass on. It will give them—and you—greater peace of mind. ■ ■ ■



INVESTMENT CHOICES MADE EASIER:
THE ACA SUGGESTED FUNDS LIST

by Penny Marchand, CFP®, EA, Tucson, AZ

With more than 9,000 mutual funds and almost 1,000 exchange-traded funds (ETFs) in the United States, wading through so many investment choices can be daunting. Do you ever wonder how your ACA advisor does it?

The Suggested Funds List helps many advisors streamline the investment decision process. The list (formerly called the Directed Portfolio) includes suggestions for both actively managed funds and passive index funds, ETFs, and Dimensional Fund Advisors (DFA) funds.

To improve the selection and ongoing evaluation of actively managed funds, the ACA investment team uses a patented process developed by Klein Decisions. This process evaluates mutual funds using an objective analysis that considers several different criteria:

Expense Ratio: Expresses the percentage of a fund's assets used to pay for operating expenses. *The lower the expense ratio, the better.*

3-year Morningstar Rating and 3-year Morningstar Risk: Measures both the historical performance of a fund compared to its peers and the fund's volatility. *The higher the rating and the lower the risk, the better.*

Fiduciary Score: Rates a mutual fund analytically with a pass/fail score based on acceptable fiduciary requirements, such as how long the fund has been in existence, manager tenure, fund assets, composition, style drift, expense ratio, alpha, Sharpe ratio, and performance relative to its peers. *A fiduciary score of 0 is most favorable.*

Rolling Return ± Category Index 1 in 5 years: Looks at each 1-year period within 5 years and averages the amount (in percentage points) by which the fund has outperformed or underperformed the category index. *The higher the rolling return, the better.*

Rolling Batting Average 3 in 5 years: Measures the fund's consistency. For example, a fund that equals or outperforms the index each month in a given period would have a batting average of 100. A fund that beats the index 50% of the time would have a score of 50. *The higher the rolling batting average, the better.*

Rolling Information Ratio 3 in 5 years: Calculates risk-adjusted performance. It's similar to a common measure of volatility called the Sharpe ratio, except it measures risk to a specific benchmark index most appropriate for the fund being evaluated. *The higher the rolling information ratio, the better.*

Duration (for bond funds only): Measures how much the fund's value will be affected by changes in interest rates. *The higher the duration, the more it will be affected by rising or falling rates.*

Average Credit Quality (for bond funds only): Describes how likely the fund's bond issuers are to default on their payments. *The higher the credit quality, the less likely it is that the fund will experience a default.*

Klein's software then assigns the funds points and ranks them. For instance, if a fund has a low expense ratio, it will get more points than a fund with a high expense ratio. If a fund has consistent returns over a 5-year period, it will score higher than a fund that has had one or two good years.

This is how the ACA investment team identifies the top 25 funds listed in each asset class. The team then screens for several other characteristics before making its final selections:

- Manager Tenure
- Brokerage availability
- Investment minimums
- Whether the fund is open or closed to new investors
- Overall suitability for clients of ACA members

The team also looks closely at funds that were previously selected but no longer appear on the top 25 list. They may choose to keep them on the Suggested Funds List with a note to ACA members, or remove them from the list altogether.

Considerable time was spent designing the final selection criteria. These characteristics help the investment team identify our top-ranked funds. The team uses a weighted scoring system, based on the selection criteria just described.

Many ACA members use their own criteria for selecting mutual funds, either as a completely separate process or in conjunction with the Selected Funds List. The list is a tool that preselects some of the best mutual funds available, leaving your advisor more time to focus on your unique financial needs.

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CARING FOR ELDERLY LOVED ONES FROM AFAR

by Karen F. Folk, Ph.D., CFP®, Urbana, IL

At one time family members—grandparents, parents, and children—lived in close proximity, often in the same house. But that was then and this is now.

According to the MetLife Mature Market Institute's *Since You Care* guide, some 34 million Americans are caring for older family members. And 15% of these caregivers, or 5.1 million, live one or more hours from the loved ones who need their help.

In many instances, long-distance caregivers not only care for a parent or older relative, but they also are employed and have dependent children. That's no easy task. Long-distance caregivers juggle the demands of two households, unable to provide direct, everyday care for older family members but responsible for arranging for and coordinating services from afar. They often have to rely on reports from others about daily events. Just as often, they have to arrange and then rearrange work schedules, business trips, and doctors' appointments. Sometimes they must make unexpected long-distance trips to deal with crises. As the American Association of Retired Persons (AARP) has noted, the responsibility can be difficult, stressful, and time consuming. But here are some suggestions that can make caring for your aging relatives more manageable:

1. Gather information and assess the need.

First, determine with your parents (and other family members) what help is needed. Use in-person visits to socialize but also to assess health and safety issues (e.g., spoiled food in the fridge, unpaid bills, poor personal hygiene). Is there anything unusual or different that could signal a problem? In discussions with parents, stress the need to find solutions that will allow them to maintain their independence as long as possible.

In some cases, you might consider hiring a professional geriatric care manager to assess a family member's needs. The National Association of Professional Geriatric Care Managers provides links to association members (www.caremanager.org). A professional geriatric care manager might charge $100 to $500 for an assessment and $60 to $90 an hour for ongoing care. If you choose this option, be sure to select a geriatric manager who is state licensed or certified. Many states and municipalities have benefits and resources to help cover the costs of some services for qualifying individuals. Another resource, the Eldercare Locator (800-677-1116), can tell you which local agencies provide services and will refer you to the area agency on aging in your parents' community.

2. Be prepared.

Before a crisis occurs, complete and distribute widely a caregiver emergency information kit. Include in the kit all necessary medical, financial, and legal information, including doctors, medications, insurance information, assets, Social Security numbers, wills, living wills, durable powers of attorney, and healthcare proxies. Ask your parents to complete HIPAA-compliant privacy release forms and file copies at the physician's office. That way, your parent's doctor can discuss the older family member's health with you. A good resource with helpful checklists is www.familycaregiving101.org. AARP also has useful long-distance care-giving resources at www.aarp.org.

3. Develop an informal network.

Experts advise adult children to establish an informal support network composed of family, neighbors, friends, clergy, and others who might help. When you're visiting your parents or older family members, introduce yourself to neighbors and friends and keep their phone numbers and addresses handy. If you can't reach a parent, calling someone in the area that you know may provide peace of mind. In addition, they may be able to help with some needed tasks.

4. Visit as often as you can.

Visit your older family members every few months to check for signs of trouble. Note, however, that professional care can be expensive. According to MetLife, caregivers spend an average of $193 per month on out-of-pocket purchases and services for the care recipient and another $199 per month in traveling and long-distance phone expenses. It may help to consult your ACA advisor early on, to ensure that your loved ones are cared for properly in the future.

This column, produced by the Financial Planning Association (FPA), the membership organization for the financial planning community, was modified by Karen Folk, CFP®, a member of the FPA and ACA.