



Private Thoughts

What's In Your Portfolio?

I met recently with Mike, a gentleman who had been referred to my firm. He is a 55 year-old business owner who is very well informed about his industry and with current geo-political events.

We had developed a pleasant working rapport over several months as I came to understand his investment objectives and concerns.

Mike had three separate accounts – a joint account with his wife, a Simplified Employee Pension (SEP) account for his business and an IRA. All three accounts were held by a nationally recognized brokerage firm, which employed his advisor.

His three accounts held 29 different mutual funds, and he had no idea what he owned. I explained that because most funds report their holdings only on a quarterly basis, the best I could do was research what he owned as of the prior quartering's ending.

Unusual? Not even. Some advisors don't know what is held in mutual funds they recommend.

Even more convoluted are the imbedded fees.

Mutual funds typically buy and sell on a frequent basis. The average domestic stock fund holds about 140 stocks. The average turnover ratio (the number of buys and sells as a percent of the total number of issues) is 89%. So a fund that holds 140 issues sells roughly 124 and buys another 124 issues over the course of a year.

The costs of these transactions are passed on to the fund holders.

In Mike's case, the 29 funds he held had turnover ratios ranging from a low of 18% to a high of 302%.

More disconcerting to him was that 18 of his funds held the same large pharmaceutical company, and while one fund was selling shares another was buying shares.

In several instances one fund was actually shorting shares that other funds were buying.

Naturally he questioned how this made sense for him as an investor.

To make matters worse, Mike's advisor had been evasive when asked about the fees to invest in these funds.

Every fund has a unique expense ratio. This is the cost of operations of the fund – also passed on to fund holders. The expense ratio includes investment management fees, legal fees, marketing expenses and a variety of other items that are customary in the management of a fund. These costs are detailed in the annual proxy each fund holder receives. Mike's funds had

annual expenses ranging from .43% to 1.95% of the fund value.

These are just the internal costs. Probably one of the greatest misconceptions in the mutual fund world is the idea that a 'no-load' fund is free. A front end (upfront) sales charge or commission has little to do with the internal cost of managing a fund.

Now, to add salt to the wound, he owned a variety of fund classes with designations (A, B C, I, F, Z and others) signifying various additional charges to the fund holder.

Typically these are indicative of a trailing fee being paid to the advisor.

Mike had no idea what he was being charged to own the funds. Surprisingly, few investors do.

In light of the past year in the market, investors need to ask more questions. All of this information is available to you from your advisor. If he cannot tell you, find one who can.

Your advisor should be able to discuss at length the following:

What do I own?

This is a very important concept for investors to understand. It is critical to understand what you own at any point in time. This is basic to managing risk. Do your holdings involve a margin of safety, or are they speculative?

Why do I own it?

This question relates to your investment outlook. What are your goals and objectives? Do you understand and agree with the investment strategy outlined for you? Do you want to preserve principal, or tolerate some risk in return for more growth?

What am I being charged?

Whether you are paying a management fee or commissions, you should know exactly what the costs entail. If you own mutual funds, know the expense ratios, turnover ratios, trailer fees, and up-front commissions.

Working with an advisor you trust is crucial. He should be able and willing to talk openly with you regarding any aspect of your relationship with him.

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