ADVISER INVESTMENTS

ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

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Legendary Vanguard Manager Passes
Howard Schow of PRIMECAP Management, a Vanguard fund manager since 1984, passed away last weekend at the age of 84. Schow eschewed the spotlight, rarely giving appearances or interviews, preferring instead to let his funds' performance do the talking for him. His keen focus and strong management served investors in PRIMECAP's funds--including many of our clients--very well over the years.

Until his health began to decline, Schow was still actively managing a sleeve of Capital Opportunity, PRIMECAP and PRIMECAP Core's portfolios, but in recent months, the PRIMECAP team began redistributing his responsibilities among the other managers and analysts, all of whom should have a thorough familiarity with Schow's portfolio.

Beyond the impact of losing one of the firm's founders and mentors, there shouldn't be too much of a transition in any of the funds--their management style and portfolios won't likely see many noticeable changes, if any. While Schow's loss is a major blow to those who knew and respected him, we don't believe that investors in any of the PRIMECAP-run funds should be worried about the integrity of their investments.

The Impact of Expenses
Vanguard recently announced adjustments to the expense ratios on 14 of its funds and ETFs. The news is mostly positive, as expenses have been reduced on 18 of the 23 affected share classes (see the full list below).

These reductions continue Vanguard's long-term history of reducing expenses whenever possible. Between 1975 and 2011, average expense ratios on Vanguard's funds have dropped more than 77%--from 0.89% to 0.20%.

While the fee reductions are good news, many investors have little understanding of expense ratios and their impact on long-term results. Expressed as a percentage of assets under management, the expense ratio tells shareholders how much they are paying to support the firm's annual cost of operating a particular fund or ETF. These expenses are deducted from the fund's or ETF's assets and therefore reduce investor's returns.

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The expense ratio is calculated by dividing annual operating expenses by the average dollar value of the fund's or ETF's assets under management. Usually, the largest operating expenses are the fees paid to the portfolio management team. Recordkeeping, custodial services, taxes, legal expenses, and accounting and auditing fees also factor into the expense ratio. Distribution and service fees--commonly referred to as 12b-1 fees--will also add to the expense ratio for those funds that still charge them (none of Vanguard's do).

Several other potential fees and expenses are not included in the expense ratio, but instead are paid directly by shareholders, when applicable. These include the sales charge or load, short-term redemption fees, trading expenses, account fees and exchange fees.

Lowered Expenses

Fund	Share Class	Old Expense Ratio	New Expense Ratio
Convertible Securities	Investor	0.68%	0.59%
Developed Markets Index	Investor	0.22%	0.20%
Emerging Markets Stock Index	Investor	0.35%	0.33%
Emerging Markets Stock Index	ETF	0.22%	0.20%
Emerging Markets Stock Index	Admiral	0.22%	0.20%
FTSE All-World ex-US Index	ETF	0.22%	0.18%
FTSE All-World ex-US Small-Cap Index	Investor	0.55%	0.50%
FTSE All-World ex-US Small-Cap Index	ETF	0.33%	0.28%
High Dividend Yield Index	Investor	0.30%	0.25%
High Dividend Yield Index	ETF	0.18%	0.13%
Selected Value	Investor	0.47%	0.45%
Total International Stock Index	Investor	0.26%	0.22%
Total International Stock Index	ETF	0.20%	0.18%
Total International Stock Index	Admiral	0.20%	0.18%
Total World Stock Index	Investor	0.45%	0.40%
Total World Stock Index	ETF	0.25%	0.22%
Wellington	Investor	0.30%	0.27%
Wellington	Admiral	0.22%	0.19%

Source: Vanguard

Increased Expenses

Fund	Share Class	Old Expense Ratio	New Expense Ratio
Diversified Equity	Investor	0.40%	0.41%
International Explorer	Investor	0.39%	0.42%
Mid-Cap Growth	Investor	0.51%	0.53%
Windsor	Investor	0.33%	0.39%
Windsor	Admiral	0.22%	0.29%

Source: Vanguard

Lower Is Better

Just as in golf, you're aiming for a low score when it comes to expense ratios. Low costs usually equate to better long-term performance, as the less you pay to the fund company each year, the more you get to keep in the way of earnings. According to a study published by Morningstar that measured fund performance between 2005 and 2010, low-cost funds outperformed high-cost funds in every time period tested.

Looking at five asset classes (domestic equity, international equity, balanced, taxable bond and municipal bond), Morningstar found that funds with expenses in the lowest quintile (the bottom 20%)

outperformed the most expensive quintile of funds in every case. High-cost funds were also more likely to be liquidated or merged into another fund.

At Adviser Investments, fund expenses have always played a significant role in our analysis of potential funds for our portfolios. All other factors being equal (specifically, management and performance), a fund with lower expenses will deliver better long-term results. It's a matter of simple arithmetic.

Each percentage point in an expense ratio represents an annual charge of $100 against every $10,000 you invest in that fund. For example, the expense ratio for Vanguard Total International Index has been reduced from 0.26% to 0.22%. This means that for every $10,000 invested in the fund, shareholders are now paying $22 each year to cover the fund's annual operating expenses, rather than $26.

While $4 a year on a $10,000 investment may not sound like much, these sums become more important when the balances are larger and the time horizons are longer. For example, let's look at the results of expenses over time on a hypothetical buy-and-hold investment in three different funds with expense ratios of 0.22%, 0.26% and 0.75%, all returning the same 6% a year. After 10 years, a $50,000 investment in the fund with 0.22% in expenses would have earned $331 more than that of the fund charging 0.26%--not a huge difference, true, but something. However, the lowest-cost fund would have returned close to $4,000 more than the fund charging 0.75% a year, nearly 8% of the initial investment. Over 20 years, those differences grow to $1,159 (0.22% vs. 0.26%) and $13,543 (0.22% vs. 0.75%)--in this scenario, all attributable to expenses.

Don't Let the Expense Tail Wag the Portfolio Dog
While those long-term numbers are fairly convincing, it's important to remember that expense ratios are just one factor to consider when making fund choices. We believe the most important element is the fund manager, because behind every actively managed mutual fund is a living, breathing person with talents, biases and a track record. We make it our business to know the fund managers, their styles and their history better than anyone else in the field. That's why our approach is to "buy the manager, not the fund."

About Adviser Investments
Adviser Investments and its subsidiaries operate as an independent, professional money management firm with particular expertise in Fidelity and Vanguard mutual funds. With 2,400 clients and over $2 billion under management, Adviser Investments is one of the nation's largest mutual fund research and money management firms. Our investment professionals focus on helping individual investors, trusts, foundations, and institutions meet their investment goals. Our minimum account size is $350,000.

For more information, please visit www.adviserinvestments.com or call 800-492-6868.