ADVISER INVESTMENT MANAGEMENT

ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investment Management

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More Multiples at Vanguard

On June 14th, Vanguard added a new management team from AXA Rosenberg to two funds, Explorer and U.S. Value. The firm, known mainly for its institutional management and quantitative style, will initially handle 10% of Explorer's portfolio and 50% of U.S. Value's. It hardly seems as though a seventh management team is necessary at the closed Explorer fund, but at this point it doesn't seem as though it could hurt too much either. We're far more interested in the effects AXA Rosenberg will have on U.S. Value, which we invest in on behalf of our clients.

AXA Rosenberg employs something of a growth-at-a-reasonable-price approach (a quantitative version of the qualitative strategy employed by the PRIMECAP Management team) to investing, relying heavily on computer modeling to screen stocks. William Edwin Ricks has been named the manager of both the Explorer and U.S. Value assets handed to his firm, but as with most quantitative strategists, his management duties mainly involve leading the team that maintains the computer models selecting the stocks.

Most of AXA Rosenberg's funds and accounts are focused overseas, but they do have some public mutual funds in the U.S. under the Laudus Rosenberg name. Two of these funds have similar objectives to Explorer and U.S. Value, and these provide our best insight as to how and what the firm might do with its portion of these funds.

The small-cap Laudus Rosenberg U.S. Discovery (RDIVX), has outperformed the Russell 2500 index (the performance benchmark for AXA Rosenberg's share of Explorer) by over 2% on an annualized basis since inception in September 2001, though recent performance has lagged somewhat. How much of a performance boost this can bring to Explorer is questionable given the small piece of the fund they'll take on, but one area the new team could affect is the portfolio's size, which is currently at nearly 1,100 stocks. The Laudus fund has held between 780 and 840 stocks at various periods, and while there's sure to be some overlap, it seems inevitable that the portfolio will grow with AXA Rosenberg's addition. We've said before, when previous managers were added to Explorer, that the fund may turn out to resemble an index with so many managers' ideas in the mix, and it's an even greater possibility now.

Laudus Rosenberg U.S. Large Capitalization Value (LCVJX) has a much shorter history to examine, but since inception in May 2005, it has outperformed U.S. Value while slightly underperforming that fund's Russell 3000 Value index benchmark. However, the Laudus fund uses the Russell 1000 Value index as its own benchmark, meaning that the composition of its half of U.S. Value's portfolio will likely be a bit different from the Laudus fund, making the comparison an approximate one.

For now, we still think that investors would be better off with one of Vanguard or Fidelity's other small-cap funds over Explorer, which has been our stance for some time. In terms of U.S. Value, we're willing to take a wait-and-see approach, but we will certainly look for alternatives if the addition of AXA Rosenberg seems to be a negative for our clients.

Kiddie Tax Growing Pains

The so-called "kiddie tax" has been changed once again, this time raising the limit from age 18 to 19, effective January 1, 2008. This comes just a year after the age limit was raised from 14 to 18 and has the potential to affect many families trying to manage their children's finances.

The kiddie tax refers to the age at which a child is taxed at their own rate, as opposed to their parents' rate, on unearned income over $1,700. For years this transition took place after a child reached the age of 14, allowing parents or other benefactors to transfer funds into a child's name at that time, which would then be taxed at a lower rate. This kind of strategy is perhaps most popularly used by parents helping children save for college, allowing the child, in effect, to pay their own tuition and saving the family a considerable sum on taxes.

With the age limit having increased to 18 and now 19 (or 24 for students who do not earn enough to pay half of what's necessary to support themselves), the traditional strategy of investing on behalf of one's child in lower-risk, income generating bonds as they approach college age has become more irksome, as any income earned will now be taxed at the parents' higher rate. Since this change won't go into effect until the first of the new year, some parents will still have time to avoid an unexpectedly large tax bill by realizing gains this year while their child still qualifies for the lower tax rate, although this will only apply to children turning 18 before the end of 2007.

Parents, or those who invest on the behalf of young children, now need to be even more cognizant of the need to focus on dividends and capital gains, which are taxed at lower rates, rather than interest income, in custodial accounts.

About Adviser Investment Management, Inc.

Adviser Investment Management, Inc. is an independent, professional money management firm specializing in Fidelity and Vanguard mutual funds. With 1,400 clients and $1 billion dollars under management, Adviser is one of the nation's largest mutual fund research and money management firms. Our staff of 27 investment professionals focuses 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.adviserinvestment.com or call 800-492-6868.

Adviser Investment Management
85 Wells Avenue
Newton, MA 02459
USA