ADVISER INVESTMENTS

ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

August 6, 2010

In This Issue

- Time to Explore Elsewhere?
- Fidelity Harnesses Alternative Energy

Time to Explore Elsewhere?

In our June 11 *Adviser Fund Update*, we covered the addition of a second management team to Vanguard International Explorer, historically one of Vanguard's best international offerings. Now that the first effects of the new addition have begun to appear, we thought we'd take a look at the changes in the portfolio and how they affect our outlook for the fund.

To review, Vanguard announced on June 9 that it had given a team from Wellington Management a small stake of the fund's assets, and also would be directing new money to the team as it flowed in. We took a look at the performance of the Hartford International Small Company fund, run by the same team added to International Explorer, and compared the performance of the two funds since current manager Simon Thomas took over the Hartford portfolio. We found that there has been some divergence between the two funds' performance in the four-plus years Thomas has run the Hartford fund, but on the whole, returns were about the same.

While the funds' performance was similar, the two funds have quite different portfolios. Adding the Wellington team to the mix has increased the number of portfolio holdings by more than 40% from 255 when Schroder Investment Management was running the fund solo, to 367 at June's end. That means that Wellington has brought something like 100-plus new companies to the portfolio, although there's almost certainly going to be some overlap. It's hard to say how much, but we were able to compare the April-end portfolios for both International Explorer and Hartford International Small Company, and it gives some insight into what can be expected going forward.

At April's end, Schroders' portfolio held almost 260 stocks and the Wellington portfolio held 124. Between the two firms, they owned 21 of the same names, but there were another 340 unique companies owned in the two portfolios (that total of 361 is not far from the 367 reported for International Explorer at June's close).

Wellington's largest two holdings, Dufry Group and Babcock International Group, at 1.8% and 1.5% of assets respectively, also appear in the Schroders portfolio. Yet for Schroders they represent miniscule 0.2% and 0.5% holdings. So, while these were big positions for Wellington, they were tiny ones for Schroders.

Conversely, the largest holding in Schroders' portfolio that is also found in the Wellington portfolio, Rheinmetall AG, represents 1.1% of assets for International Explorer, making it the fourth-largest holding for the fund. Yet at 0.8% of assets, it's the forty-ninth-largest holding in the Wellington portfolio.

Clearly the two management teams have very different opinions on which are the best companies in the small-cap international space, as can be seen by the relative lack of shared holdings. This difference of opinion is not necessarily a bad thing- if both teams had identical portfolios, there'd be no reason for the addition. A main source of concern is the fact that Vanguard apparently didn't give Wellington any specific guidelines about keeping either the size and/or concentration in its portfolio under control. If the portfolio becomes too bloated, International Explorer may become index-like in its composition and performance, like many other multi-managed funds before it.

We remain curious as to why Vanguard felt they needed to dilute what was once an excellent fund, but we're not ready to sound the evacuation order quite yet. That said, Vanguard's relatively new World ex-U.S. SmallCap Index invests in the same international small-cap universe and has performed quite competitively since its 2009 inception. The index fund's low-cost ETF shares could make a decent alternative if International Explorer suffers from the Wellington addition.

Fidelity Harnesses Alternative Energy

Early last month, Fidelity changed the name of its Select Environmental fund to Select Environment and Alternative Energy, and made a switch in the fund's management. The new name reflects an increased exposure to the alternative energy and energy efficiency industries and a reduction to holdings in other areas like waste management, for example.

In terms of management, Anna Davydova has been given sole responsibility for the fund, which she had co-managed since March of this year with Douglas Simmons. Simmons will continue to manage the Telecom and Utilities fund as well as Fidelity Select Utilities (the Advisor and VIP share classes too). He'll also continue to have responsibility for the telecommunications services and utilities sectors within Fidelity's Multi-Manager Group. Davydova joined Fidelity in 2005 as a research analyst covering coal, small-cap oil services and oil tankers. In 2007, she began covering the alternative energy sector.

The fund will now likely have a broader investment universe and a higher allocation to foreign markets due to the global nature of the alternative and renewable energy industries. The addition of alternative energy is both smart management and smart marketing, but we would still advise a majority of investors to steer clear of this fund, as it will remain very narrowly focused (just less so) and won't be a good fit for most portfolios.

About Adviser Investments

Adviser Investments is an independent, professional money management firm specializing in Fidelity and Vanguard mutual funds. With 1,500 clients and over $1 billion dollars under management, Adviser is one of the nation's largest mutual fund research and money management firms. Our staff of 35 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.adviserinvestments.com or call 800-492-6868.