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Turbulence at the Top for Fidelity

On Tuesday, August 7th, Ellyn McColgan, president of Fidelity Investments Distribution and Operations, announced that she was resigning from her post to pursue new opportunities. This is a considerable shakeup to Fidelity's top management structure, as many considered McColgan to be the leading candidate to succeed Ned Johnson (Fidelity's chairman and CEO) when he steps down sometime in the next several years.

However, the hiring of Rodger Lawson as president of FMR in July placed him as an intermediary between McColgan and Johnson, in effect a demotion, which apparently spurred McColgan to seek her fortunes elsewhere.

For now, Lawson will temporarily fulfill McColgan's role, and the position could eventually be filled from outside the current management ranks. McColgan's resignation also leads to renewed questioning as to how Johnson's succession will be handled. For now, of the candidates publicly discussed to take on the CEO role, only Ned's daughter, Abigail Johnson, remains with the firm, as president of the Employer Services Co., overseeing corporate retirement plans.

While McColgan's loss is a hit for Fidelity--many credit her with single-handedly turning Fidelity's brokerage business around, and her aggressive management style fit well with Johnson's philosoph--investors in the firm's funds will not be affected by her departure.

Vanguard Wants More Active ETFs

Vanguard has filed with the SEC to offer new ETF share classes of four bond funds: Inflation-Protected Securities, Short-Term Treasury, Intermediate-Term Treasury and Long-Term Treasury.

We mentioned the prospect of an "actively managed" ETF a couple of months ago, when Vanguard first expressed its intention to create an ETF share class based on Inflation-Protected Securities. Since then, they've perhaps become more ambitious, with the addition of the three Treasury funds to their filing with the SEC, but as we touched upon in that earlier piece, as far as actively managed funds go, Vanguard's bond funds are some of the tamest in the business.

Despite that, Vanguard faces a hurdle with the SEC, as it needs to prove it can provide nearly instant portfolio transparency so that the

ETFs can be accurately priced for trading. While these funds stand a strong chance of leaping this hurdle due to their low turnover, it is by no means a sure thing, especially since the SEC has to consider what kind of precedent they want to set by allowing "active" ETFs to hit the market.

Whether or not Vanguard successfully brings these ETFs to the market should not be a big concern for investors. One can already purchase the investor share class of these funds for between 0.20% to 0.26% in expenses and between 0.10% to 0.11% for Admiral shares. If the SEC does give the thumbs up, and the ETF shares offer lower expenses, the funds could serve as a lower-cost alternative to the investor shares for those unable to meet the Admiral funds' minimums.

Europe Pacific Debuts

Vanguard's MSCI EAFE tracking ETF made its entrance stage right on July 25th, the first act in an attempt to lure market share away from the higher-cost iShares ETF following the same benchmark. Europe Pacific ETF, a share class of Vanguard's Tax-Managed International fund, has an expense ratio of 0.15%, 20 basis points (or 0.20%) less than the iShares EAFE Index ETF's 0.35% (ticker: EFA). It will be interesting to see how quickly the ETF gathers assets and if the EFA is noticeably affected. One issue that isn't addressed in the "we've got lower costs than you do" argument is the impact of trading spreads between bid and ask prices. The new Vanguard ETF won't have the volume to narrow spreads the way the iShares product does, and hence its adoption in the marketplace could take some time.

For investors who already own a broad international fund in their portfolio, there is probably no need to buy into Europe Pacific, which excludes emerging markets, but it is always a plus to have more low-cost options out there.

Fidelity Manager Moves

As of September 4th, Fidelity's Freedom and Advisor Freedom funds will be getting a bit of a shakeup as Christopher L. Sharpe replaces Ren Y. Cheng as co-manager. Cheng will be transitioning to chief investment officer of the Global Asset Allocation Group, where he will oversee Fidelity's lifecycle and asset allocation portfolios. Sharpe's counterpart on the Freedom and Advisor Freedom funds will be current co-manager Jonathan A. Shelon, who has also been appointed co-manager of a number of VIP Freedom funds, another role vacated by Cheng. Sharpe will retain his position as co-manager of Four-in-One Index and several funds for Canadian investors. He's been with Fidelity since 2002, getting his start as an asset allocation director, constructing portfolios for institutional clients. He got his shot at management in 2005 with the VIP Freedom Portfolios. Shelon joined Fidelity in 2001, managing institutional portfolios, moving up to co-manager of the Advisor Freedom funds in 2003 and the Freedom funds in 2005.

With Cheng's new appointment, the domino effect benefits Derek L. Young, who will take on sole management responsibilities for Strategic Income, Strategic Dividend & Income and Strategic Real Return (he will also manage the Advisor class of all three funds and the VIP class of Strategic Income), which he currently co-manages with Sharpe. Young will continue to co-manage Four-in-One Index, Global Balanced, VIP Asset Manager and VIP Asset Manager Growth. He's been with the

firm since 1996, where he started out as director of risk management for the Fidelity Management Trust Company (FMTC). He moved up through the ranks to a senior vice president and member of the FMTC Trust Committee. Young began managing several of the above-listed funds in 2005, adding one or two a year to his responsibilities since then up to his most recent promotion.

As of August 1st, Fidelity's Total Bond fund got a new co-manager, as Matthew J. Conti replaced Eric Mollenhauer, who is moving on to manage some institutional bond portfolios. Ford O'Neil remains the fund's lead manager. Conti will continue to manage Focused High Income (along with Advisor and VIP clones), the high-yield portions of the Asset Manager funds, as well as high-yield institutional portfolios. He came aboard in 1995 as an analyst covering high-yield investments in a number of industries. Conti was appointed manager of the high-yield segments of the Asset Manager funds and some institutional portfolios in 2000. From 2001 to 2004 he was given responsibility for the High Income funds and Focused High Income.

None of these manager moves affect our opinion of these funds, several of which--Strategic Dividend & Income, Strategic Income and Total Bond--we own on behalf of our clients.

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