ADVISER INVESTMENT MANAGEMENT

ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investment Management

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New Funds Sown

As the summer begins to wind down and the growing season ends, both Fidelity and Vanguard are preparing to plant new funds in the market.

Fidelity's New Crops

Fidelity has filed with the SEC to open three new funds. The first will be called Dynamic Strategies, and it will be a cross between a fund of funds and a traditional mutual fund, investing in a number of Fidelity's funds and ETFs, along with some stocks. Its goal is high total return, and it will pursue it by investing in domestic and foreign markets, mixing in long-and short-term investments. So a real go-anywhere fund, although which direction it will go in once it opens remains to be seen.

The firm also has two new international funds in the works: International Growth and Total International Equity. They will both seek long-term growth of capital via investing in primarily non-U.S. companies. International Growth will seek its fortune in companies that are believed to have above-average growth potential. Total International Equity is set to track the MSCI All Country World ex-US Index (a global index designed to measure equity performance in developed and emerging markets, minus the US), and it will invest in both growth and value stocks.

Vanguard's Land Grab

Vanguard has filed to open a long-short fund, also known as an absolute-return or market-neutral fund, geared toward high-net worth and institutional investors, before the end of the year.

The fund, to be named Market Neutral, is actually not a creation of Vanguard's, instead the firm will be adopting an existing fund, the Laudus Rosenberg US Large/Mid Capitalization Long/Short Equity fund (RMNIX). RMNIX is currently run by AXA Rosenberg, the firm which took on half of U.S. Value, as well as a piece of Explorer earlier this year. Once the transition is complete, Vanguard's Quantitative Equity team will be added to Market Neutral's managerial mix.

Market Neutral's goal will be to beat the return of a 3-month Treasury bill, a benchmark chosen for the fact that it should be extremely low-risk. This fits, because the idea of a "market neutral" fund is, in theory, one that is immune to systematic or economic factors. The intended result is a fund where the only risk is that stemming from the stock picking ability of the managers.

RMNIX hit the market in November, 1998, and AXA Rosenberg has been the manager for the duration. The firm has primarily used the S&P 500 as its universe, picking about 90 of the stocks they felt were most undervalued, while selling short 90 of the ones they felt were most overvalued. (Short selling is the process of "borrowing" shares from third parties, selling those shares and pocketing the proceeds, hoping that when you are called upon to replace the borrowed shares, or decide to do so on your own volition, you can do so at lower prices, hence making money on a stock's declining price.)

While the fund has well outperformed the return from cash, it has done so with marked volatility, including a more than 9% decline in Q4 2001 and a better than 16% gain the quarter before. These kinds of swings have lead us to question whether or not the fund has truly achieved market neutrality-in fact the fund has about matched the returns of Vanguard's Total Bond Market Index, but with much greater volatility. Investors would have been better off in the rather conservative Wellesley Income (and experienced a much smoother ride) over the same period.

As RMNIX, the fund has a $100 minimum initial investment, and a rather paltry $21 million in assets. As Market Neutral, the minimum will be bumped up to a very hefty $250,000 for investor shares and $5 million for institutional shares, putting it well out of reach for most investors. But this shouldn't be a concern, as first, we think one could do better with existing Vanguard and Fidelity funds, and second, because Vanguard is clearly gearing this fund towards institutional markets.

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.

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