ADVISER INVESTMENTS

ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

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Fidelity Unveils Sector ETFs

On October 24, Fidelity launched a suite of 10 sector ETFs, which are in direct competition with very similar offerings from Vanguard. With expense ratios of 0.12%, the new ETFs became the lowest-cost passively managed sector ETFs in the industry. Investors can purchase the ETFs commission-free through the firm's online brokerage platforms.

The ETFs represent the latest volley in the long-running fee war between Fidelity and Vanguard. This time, it's Fidelity striking a blow, as the new ETFs each charge less in expenses than the comparable offerings from Vanguard. You can see how they match up in the table below.

Both sets of ETFs track MSCI indexes, however, only the two telecom ETFs share an identical underlying index. The rest track similar, but distinct versions of their sectors' index. The differences lie in the fact that Vanguard made the switch in early 2010 to the "25/50" versions of MSCI's sector indexes, which are designed so that no more than 25% of assets are invested in a single stock and the allocation to all stocks representing more than 5% of the index each do not exceed 50% of total assets. The 25/50 indexes were adopted to keep the ETFs from violating SEC diversification rules. For now, Fidelity and its sector ETF sub-advisor BlackRock (which owns the iShares line of ETFs) have chosen to mostly avoid the 25/50 versions of MSCI's sector indexes.

From one perspective, Fidelity's product launch is a bit of a head-scratcher, strategically. Fidelity already offers a wide range of actively managed Select sector funds, which cost significantly more and could bleed assets into the cheaper passive sector ETFs. Have the fee wars between Fidelity and Vanguard grown so heated that the firm is willing cannibalize some of its established offerings as a way to undercut Vanguard? Its seems like that might be the case—in a recent conference call, Fidelity said that the ETFs will meet the needs of investors interested in intraday trading and the indexing approach, while the older, actively managed Select fund lineup should appeal more to those with a longer investment horizon.

The new ETFs might lure investors away from Fidelity's Select funds, but their introduction brings the potential of greater overall assets under management. ETFs have exploded in assets since their advent, and Fidelity wants to finally get on the field after sitting on the sidelines for more than a decade. "We are not building an at-scale passive ETF business," Anthony Rochte, head of Fidelity's sector-investing unit, told *Barron's*. "Frankly, we're trying to meet the needs of our customers."

Fee Wars Hit Sector ETFs

ETF Name	Ticker	Expense Ratio	Comparable Vanguard ETF Expenses
Fidelity MSCI Consumer Discretionary Index ETF	FDIS	0.12%	0.14%
Fidelity MSCI Consumer Staples Index ETF	FSTA	0.12%	0.14%
Fidelity MSCI Energy Index ETF	FENY	0.12%	0.14%
Fidelity MSCI Financials Index ETF	FNCL	0.12%	0.19%
Fidelity MSCI Health Care Index ETF	FHLC	0.12%	0.14%
Fidelity MSCI Industrials Index ETF	FIDU	0.12%	0.14%
Fidelity MSCI Information Technology Index ETF	FTEC	0.12%	0.14%
Fidelity MSCI Materials Index ETF	FMAT	0.12%	0.14%
Fidelity MSCI Telecommunications Services Index ETF	FCOM	0.12%	0.14%
Fidelity MSCI Utilities Index ETF	FUTY	0.12%	0.14%

Sources: Fidelity, Vanguard.

While the introduction of low-cost funds benefits investors, we feel it's important to remember that sector investing is risky. Whether you pick an actively managed sector fund or an index-based sector ETF, you are making a bet on a narrow slice of the market, one which could see considerably greater volatility than a diversified investment. We think Fidelity's sector ETFs hold limited appeal for most individual investors, but would not be surprised to see them gain some assets as institutional investors gravitate to their lower expenses.

Vanguard's Fixed-Income Chief Retiring

Following the lead of former fixed-income head Ian MacKinnon, who retired in June 2003 at the age of 55, Bob Auwaerter, 58, is stepping down March 2014. His replacement, Greg Davis, will only be Vanguard's third fixed-income chief.

We do not believe Vanguard fixed-income investors will see any noticeable impact on their funds. Auwaerter leaves behind a deep and broad bench of analysts and portfolio managers and he handed over active management duties to Greg Nassour years ago.

Davis is currently Vanguard's chief investment officer in the Asia Pacific region and also serves as director of Vanguard Investments Australia. He's been with Vanguard since 1999, and not too long ago served as a portfolio manager and the head of bond indexing in Vanguard's Fixed Income Group, experiences which should benefit him when he takes over the entire division next year.

Vanguard International Growth Manager Departs
Virginnie Maisonneuve, who was the lead manager on Schroder Investment Management's portion of the Vanguard International Growth fund, is decamping for PIMCO at the end of the year to become that firm's global head of equities and a portfolio manager (Vanguard has already removed her name from the fund's page on its website).

Maisonneuve took over for veteran Richard Foulkes upon his retirement in 2005 as lead manager on Schroders' piece of International Growth. At the time, Schroders managed a bit more than 70% of the fund's $11.5 billion in assets. More recently, Maisonneuve and co-manager Simon Webber (who was added to the fund in 2009 and has taken over as lead manager) were running less than 40% of the $21.2 billion asset base, or about the same $8 billion Schroders was responsible for when Maisonneuve first took the reins. Managers from M&G Investment Management and Baillie Gifford manage the 60%-plus of assets in International Growth not under Schroders' control.

Maisonneuve is a talented portfolio manager—one who we've had the chance to speak with a number of times over the years—but we don't see her departure from International Growth as a cause for concern for current investors.

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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 more than $2.5 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. Adviser Investments was recently named to *Barron's* list of the top 100 independent

financial advisors nationwide.

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