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Pooled investment simplicity can be deceiving

So you think you are having a good year? The market is certainly doing well enough and returns on your mutual fund investments probably look pretty good on paper.

But what is your real return? Are your mutual fund investments losing some of their glitter due to unexpected transaction costs, taxes and payouts? It happens more often than you think.

Although pooled investment vehicles like mutual funds and common trust funds can make investment decisions appear less complicated, unforeseen headaches can lurk beneath the veneer of simplicity.

You have no real control over what happens to your money while invested in a pooled vehicle. The fund manager decides what to buy or sell and when to do it.

As a result, you get stuck with transaction costs that can eat into your bottom line. Even worse, a fund manager's actions may not only lower your return but also increase your taxes.

Consider this scenario: you are heavily invested in a mutual fund that hires a new manager. The new guy wants to make his mark on the fund, so he sells off shares and buys others.

You will pay the transaction costs and the capital gains tax whether or not those changes to the fund's assets benefited your portfolio.

Or suppose several other owners in the fund call for disbursements. Your fund manager may have to sell fund assets to raise the cash. Any net gains realized will result in a tax bill for you, even though you



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did not make any changes in your own portfolio.

This can be particularly tiresome when these capital gains are distributed in years where the actual market value of your investment has gone down.

That isn't likely to have happened in the past year. But it has happened before and will again – it is just a matter of time.

With common trust funds or proprietary mutual funds you should also be aware that liquidation of these investments is probably required if you decide to change investment managers.

Said another way, you would be forced to realize capital gains just to move your account. This is very different than transferring individual securities "in-kind" where any tax implications can be managed appropriately.

If you have significant capital to invest, you can avoid these deficiencies by building a diversified portfolio of individual securities across a variety of industries.

This way, you own the portfolio and you decide when to buy and sell. And with the help of a trusted financial professional, you can create a plan that will protect more of your assets from Uncle Sam. We should all pay our fair share, but there is

no reason to pay more.

In pursuit of the most relevant net return on your investments, you might have also wondered why your mutual fund contains 200 or more securities?

Often, the answer is that the fund manager cannot buy enough of the stocks he wants; yet he must keep the fund fully invested, so he falls back on second- or third-tier issues.

That means part of your money is propping up sub-standard stocks just so the fund can remain fully invested.

It is certainly true that in tax-deferred accounts such as 401-Ks and IRAs, a fund's tax inefficiency is less of a concern but the other potential issues remain.

Deciding between individual securities and pooled investment vehicles should be done on a case-by-case basis. Understanding the characteristics of how funds operate will help the evaluation of your net investment returns, which is far more relevant than what may be found in the marketing materials.

Increasing your net return by only one-half of one percent a year, for ten years, means an extra \$51,140 on a \$1million portfolio – certainly enough to justify a discussion.

Ask your financial advisor about building your own diversified portfolio and building your personal investor confidence and your personal wealth.

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