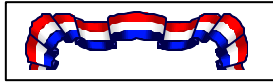




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ICG TIMELY TOPICS



From The Top

News of Note

Regulation is never a pleasant experience but sometimes it is necessary. Plan Sponsors have a fiduciary responsibility to monitor Plan fees and expenses. These generally fall into three categories. 1) Plan Administration Fees, which include plan record keeping, accounting, legal and trust services. 2) Investment Fees, which are the fees for investment management and other related services, assessed as a percent of assets invested. 3) Individual Service Fees that are associated with optional services for an individual such as loans or self-directed accounts.

The Department of Labor has issued a directive to Plan trustees. It states that Plan fiduciaries have a responsibility to review late trading and market timing issues regarding their mutual funds.

Donald R. Stanforth, President
Certified Investment Management Analyst

Article Summaries

**Picerno, James “*Market Matters – Bull Market in Regulation*” Bloomberg Wealth Management
December 2004/January 2005 p. 105**

Listed below is a rundown of recently published SEC final rules affecting mutual funds. The new regulations require

- Enhanced reporting of portfolio managers’ compensation and potential conflicts of interest
- Enhanced disclosure of market-timing policies and procedures
- Enhanced disclosure of practices regarding the “fair valuation” of securities in the portfolio
- Adoption of a code of ethics
- Additional details on how a mutual fund’s board of directors evaluates and approves investment-advisory contracts
- That 75 percent of a mutual fund’s board members, and its chairman, be “independent”
- More information on so-called break-point discounts on front-end loads
- Adoption of new, more stringent compliance programs
- Disclosure of a mutual fund’s proxy voting record for stocks in the portfolio

No one knows for sure how many additional disclosure mandates are coming from the SEC or – perhaps more worrisome is whether Congress will join in the fray. Congressional action, if it comes, is likely to place even stricter regulatory burdens on mutual funds.

Hoffman, David “Faith-based funds make gains but stay small” Investment News Vol. 8, No. 48, December 20, 2004 pp. 2, 68

Assets in faith-based funds that invest according to religious principals are growing, but some industry experts doubt they will ever account for anything more than a very small part of the socially conscious mutual fund universe. Faith-based funds had total assets of \$4.7 billion through October 2004, up from \$3.3 billion at the end of 2002.

Some fund experts said they find it hard to believe that the funds will collect enough assets to be considered a major fund class. It seems that folks who have concerns about the ramification of their mutual fund investments tend to favor the classic socially responsible funds. Part of the problem for faith-based funds may be that they are trying to carve up their niche a little too finely, according to some industry experts.

Some believe that there is still massive opportunity within the faith-based community to help people understand and feel empowered to bring their faith values to the investment arena. One way to do that is to be a “pioneer” when it comes to issues that appeal to all socially conscious investors, not just investors of one religion. Of course, what may be the biggest determinant of whether faith-based mutual funds continue to increase assets is performance.

Williamson, Christine “The Crimson lead the pack” Pension & Investments February 21, 2005 p. 20

Harvard University is the country’s largest endowment, topping its nearest rival, Yale University, by nearly \$10 billion. Boston-based Harvard led the survey of U.S. endowments by the National Association of College and University Business Officers with \$22.1 billion in its endowment pool as of June 30, 2004, a 17.5% increase from the same date in 2003. The endowment at Yale, totaled \$12.7 billion at midyear. Rounding out the top five were: the University of Texas System with \$10.3 billion; Princeton University and Stanford University with each topping \$9.9 billion. The reason for the big bump was simple: Equity returns were up sharply in 2004, which benefited many equity-heavy endowments.

The survey generally found little difference between the investment profile of endowments of public vs. private institutions, but did point to a strong correlation between size and performance. Endowments larger than \$1 billion returned an average of 17.2%. Average performance of smaller endowments was significantly lower, with a 12.4% return for endowments with less than \$25 million.

Endowment size also was a significant factor when it came to asset allocation. As asset size increased, allocations to alternative investments increased while equity and fixed income fell.

Hoffman, David “Benchmark indexes made their mark in ‘04” Investment News Vol. 9, No. 4, January 31, 2005 p. 6

Score one for the passive investor. Benchmark indexes outperformed actively managed mutual funds in all but one style box in 2004. Equal and asset-weighted average returns for active funds lagged benchmarks in 2004, the exception being large-cap growth. In 2003, a majority of active funds outperformed indexes in five of nine style boxes.

An index strategist at Standard & Poor’s said the scorecard’s results help dispel the myth that index funds outperform actively managed funds only in rising markets. The reason: Although many consider 2004 a “sideways” market that saw only modest growth, the benchmarks still came out on top. In 2003 actively managed funds did better. There is no consistency in active-versus-index results in the short term.

Gabriel, Frederick P. Jr. “Fund execs show little sympathy for Morningstar’s misfortunes” Pensions & Investments January 24, 2005 p. 63

Now that Morningstar Inc. finds itself in hot water with regulators, some in the club by world of mutual funds are taking delight in its travails. The influential Chicago-based fund research company has long been revered – and feared – by even the most powerful in the fund industry. Now, as the company is at the center of two government probes and trying to go public, there is no shortage of those reveling in its misfortune. The schadenfreude surrounding Morningstar might be a reflection of the mood of fund company executives. Misery loves company and right now there are a lot of miserable fund company executives out there. That isn’t to say Morningstar has worked very hard to make friends in the fund industry. It is, after all, the same company that responded to the scandal by advising investors to withhold additional investments in the implicated fund companies and in some cases to “consider selling” their holdings. Morningstar has since reversed its position on most of the companies, citing improvements made in the light of the scandal.

Morningstar officials, for their part, are taking the public hazing in stride. To some in the \$7.5 trillion fund industry, Morningstar is simply getting its comeuppance for amassing so much power, thanks to its hugely popular star rating system. While funds don’t live or die by the company’s rating, a top-rated fund certainly gets noticed by financial advisers as well as individual investors. Despite Morningstar’s power – or maybe because of it – its goody-two-shoes public image is under attack.

Last spring, the Securities and Exchange commission launched an investigation into the company after it failed to correct some inaccurate fund data on its website promptly. Then in December, New York Attorney General Eliot L. Spitzer began poking around the activities of Morningstar Associates, LLC, a subsidiary that offers investment counseling services to providers of retirement plans. For Morningstar, the investigations come at a bad time. In May, the company filed plans for an initial public offering. On January 7, the company said it had hired WR Hambrecht + Co. of San Francisco to sell its shares through a Dutch auction rather than a traditional sale.

Sortino, Frank “Misinterpretations can lead to costly financial mistakes” Pensions & Investments February 7, 2005 p. 21

Figures never lie, but they are subject to interpretation and more often, misinterpretation. The PRI Preferred List shows the top funds in each of nine style categories. They started with approximately 20,000 mutual funds and filtered them down to 22. Here is how they are open to misinterpretation. First, suppose a 401(k) participant had been shown this list at the end of the third quarter 2004. The participant probably would have said “They were projecting all these high returns in the teens, but look, they almost all earned negative returns in the last quarter. I’m not going to buy these losers. I’ll keep my money in T-bills, where it’s safe.” Well, all the funds on the list were up substantially in the fourth quarter. Furthermore, those safe T-Bills guarantee the participant will never earn enough money on his/her investment to retire. Second misinterpretation is accepting the PRI methodology as a representation for the market as a whole. It is not reasonable to compare a small cap growth fund with a large cap index. The real market has more than 6,000 stocks. For the third misinterpretation the style listed may be misleading. There are a few who say “One should compare each fund with a peer group.” The problem can best be shown with the following example. Merrill Lynch Small-Cap Growth Fund is 70% small-cap core and only 16% small-cap growth.

So what is an investor to do? Recognize that all managers are a blend of passive indexes; purity is non-existent.

**Paikert, Charles “Best and worst: Morningstar rates 529 college savings plans” Investment News
Vol. 9, No. 8, February 28, 2005 p. 13**

Section 529 college savings plans from Alaska, Utah, Michigan, Colorado, Kansas and Virginia were named the best in the country in Morningstar Inc.’s second annual examination of plans, while those from Alabama, Arizona, Maine, Tennessee and Wyoming were described as the worst. Investors are naturally inclined to choose the plan sponsored by their home states, especially when half offer tax incentives to in-state residents. Since many in-state plans are not attractive, the report urges investors to consider out-of-state choices.

The direct-sold Utah Educational Savings Plan Trust in Salt Lake City continues to set the standard for low costs among 529 plans, offering cheap index funds from Vanguard and charging just .25% for administration chores. Among brokerage sold plans, which account for 80% of 529 plan assets, the top choice is Virginia CollegeAmerica plan. Twenty-one funds from American Funds are offered. Brokers have the flexibility to craft well-diversified portfolios to meet their clients’ needs. On the other end of the spectrum, Wyoming’s 529 plan charges a .95% annualized program management fee, on top of the underlying fund cost. Alabama and Tennessee were singled out for subpar plans and no meaningful tax break to keep investors in state. Gordie Cossan, a certified financial planner, applauded the study’s emphasis on examining out-of-state plans, noting that many people consider only their home-state plan because they either think most plans are the same or even erroneously think they are required to use the in-state plan.

**White, Jesse (Secretary of State) “Securities bulletin” A Newsletter of the Illinois Securities
Department Winter 2005 p. 1**

Investment advisers have a fiduciary duty to provide advice that is in the best interest of a client and to disclose all conflicts and fees. This is not necessarily true for a salesperson at a brokerage firm. Brokerage salespeople must sell suitable investments, but do not have the same disclosure and fiduciary obligations.

The distinction between advisers and brokers is not clear to many investors. Brokers often refer to themselves as “financial advisers,” or other names to lull investors into believing they are dealing with investment advisers and not just salespeople.

A Securities & Exchange Commission recently proposed a rule that would exempt certain broker-dealers from registering under the Investment Advisers Act. The new rule would allow brokers to provide incidental investment advice without meeting all the requirements that investment advisers must adhere to. Individual investors, consumer advocates, the North American Securities Administrators Association and others submitted compelling comments to the SEC opposing this rule.

Regardless of the SEC’s final decision, I encourage all investors to question their financial professional before investing. To verify whether your investment professional is registered as an investment adviser, salesperson or both, please call the Securities Department at 800-628-7937.