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Mutual fund scandals are offensive

The recent alleged misdeeds by a number of mutual funds is appalling.

Although the prospectus may give the impression that these fund companies were against day trading, a little extra revenue to improve the bottom line convinced them turn the cheek, at the expense of the underlying shareholders.

The press has been quick to also blame market timers, but frequently it's simple arbitrage.

The markets close much earlier abroad than in the United States, but investors are allowed to buy an international mutual fund until 2 p.m. MST.

A significant event (such as an interest cut) after the international markets close but before our markets close should signal a high likelihood that the following day will be strong in foreign markets.

In addition, a strong day in the U.S. market traditionally signals a high likelihood of a big day in the non-U.S. markets.

The ability to buy an international mutual fund hours after the foreign markets close offers an advantage, and a sale at the end of the next day would generate handsome short-term profits. It's like placing the bet after the cards are on the table, and only a few were given this opportunity to arbitrage.

Mutual fund companies allowing this sort of activity clearly crossed the line, as this

day trading costs all fund shareholders.

Transaction costs generated by the arbitrageurs were spread to all shareholders.

Some fund companies rationalized the activity by keeping cash in the fund to handle these trades. But this cash should have been invested in securities.

Shareholder damages are nearly impossible to calculate, but in reality, financial loss is probably fairly minimal, most likely under 10 basis points (one-tenth of 1 percent). However, the behavior cannot be excused.

If you own a mutual fund from one of the families that's involved in the scandal, we believe the situation should be analyzed on a fund-by-fund basis.

The Janus fund family is a perfect example. The Janus Growth & Income Fund managed by David Corkins is still a quality product. The Janus Small and Mid Cap Value products sub-advised by Perkins, Wolf and McDonnell are solid as well.

Conversely, because Helen Hayes no longer is at the helm of the Janus Overseas fund, we are deeply concerned about it and believe it should be replaced because of her departure.

Additionally, there's Putnam's firing of Omid Kamshad, lead manager and chief investment officer for the Putnam International Equity Fund. He was directly involved with day trading his own mutual fund.

We believe investors should go elsewhere in this case, as there are plenty of quality alternatives.

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