

SHOULD YOU ABANDON MUTUAL FUNDS?

Are you thinking about bailing out of specific mutual funds because they're under investigation – or even abandoning mutual funds altogether? While CERTIFIED FINANCIAL PLANNER™ professionals are just as angry as fund investors by the revelations, they caution investors against making rash moves that might potentially damage their personal finances even more than losses from the funds themselves.

Many of the 95 million investors who hold \$7 trillion in mutual funds have lost faith in mutual funds or are considering leaving individual funds because they disapprove of the funds' actions. A November *USA Today*/CNN/Gallup poll found that one in four mutual fund investors are less likely to invest in mutual funds now and seven in ten would either “probably” or “definitely” pull out of a fund under investigation.

If you're among those thinking of leaving a specific fund or pulling out of all your mutual funds, here are some points to ponder first.

What will fees cost you? Any time you buy, sell or exchange a mutual fund, you may pay fees. For example, some mutual funds impose back-end or redemption fees if you sell within a certain time after purchase. You also may face an exchange fee for simply trading funds within a family, or if you sell a fund and buy into a new fund in another family, you may incur sales fees.

What will taxes cost you? If you're bailing out of a taxable fund, you may have capital gains taxes to pay – potentially large ones if you've held the fund for a while.

Taxes won't be an issue for funds you're holding inside qualified retirement accounts – unless you pull money out of the account itself. Then you'll pay ordinary federal and possibly state income taxes on withdrawals, and lose the opportunity for further tax-deferred growth. In addition, you'll probably pay a ten percent penalty if you're younger than age 59 1/2.

If you still want to get out of a particular fund, consider moving the money into other mutual funds available within the retirement plan or account. If you don't want to be in stock or bond funds at all, at least stay in the plan through its money market or stable value

fund options. Remember, if you stop contributing to your employer's retirement plan altogether, you may miss out on the "free money" of an employer match.

What will it cost you to stay? On the other hand, there can be costs to staying in a mutual fund that's being investigated. If many shareholders are abandoning the fund, massive redemptions could cause two potential problems for those who stay. First, the fund's fixed operating costs will be spread over a smaller pool of investors, thus reducing their returns. Second, the fund may have to sell some of its winning stocks in order to meet redemption demands, thus hurting the fund's overall performance and generating capital gains on which the remaining shareholders will have to pay tax.

Where will you go? If you pull out of a particular fund or funds under investigation, where will you put your money? Investigations by federal and state authorities are broadening, so a "clean" mutual fund you shift into today may be under investigation tomorrow.

Second, if you abandon mutual funds entirely, where will you invest? Financial planners have long been proponents of mutual funds because they provide benefits that most investors can't mimic on their own. For example, stock mutual funds typically own dozens, sometimes hundreds, of individual stocks, providing diversification that most individual investors can't match on their own. And many employer-sponsored retirement plans don't offer the option of individual stocks, direct real estate and other investment alternatives even if you could afford to diversify. Mutual funds also are professionally managed. Most individual investors have neither the time nor expertise to knowledgeably pick individual stocks.

Some observers have suggested that mutual fund investors consider alternatives to mutual funds such as separately managed accounts and exchange-traded funds, which are essentially index mutual funds traded like stocks. But these alternatives have their pros and cons, too.

Withdrawing from a specific mutual fund under investigation, either out of fear of losing money or in protest, is understandable and in some cases appropriate. But before making any hasty withdrawals or abandoning funds altogether, CFP® professionals recommend making sure the costs don't outweigh the benefits.

December 2003— This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by local member Bill Rodau, MS, MBA, CFP® at *Creative Financial Services, Inc.*, 262-820-0870, www.imfeeonly.com. The column is provided for your general information only and you should contact this planner or other professionals for specific advice regarding your situation.