MAINSTAY CAPITAL MANAGEMENT LLC

The Mutual Fund Mess
(11/13/03)

You no doubt have seen or heard some of the criticism leveled at a number of mutual fund companies and brokerage firms in the past several weeks. The alleged transgressions have varied widely, but focus mostly on market timing, late-day trading, and mutual fund sales practices. We will review all of these problems and our current and future measures to safeguard your assets and portfolio performance. First, however, we want to remind our clients that Mainstay Capital Management does not receive a penny in monetary compensation from any mutual fund company, brokerage firm, or insurance company (annuities). Therefore, you can rest assured that the actions we take are not in any way biased by a business relationship with any of the companies involved. As a fee-based, independent, investment advisor, our only loyalty is to our clients, and therefore, our clients' best interests are the only consideration in our actions.

Mutual Fund Sales Practices

Securities regulators are investigating brokerages that directed clients toward funds with large commissions rather than more appropriate funds. Regulators are also looking into the inappropriate sales of "B-class" (or back-end load) mutual fund shares because of high commissions paid to brokers when another class of shares may have been more appropriate.

In this case and others like it, MCM clients are unaffected, as we do not buy B-class shares. Nor do we receive any monetary compensation from mutual fund companies, brokerage firms, or insurance companies for the investments we hold in your portfolio. Frankly, we are very glad that these inappropriate mutual fund sales practices are being brought to the public's attention by the media and securities regulators. If you, a family member, or friend work with an advisor who is compensated by a mutual fund company, broker, or insurance company (annuities), we strongly advise that all compensation arrangements and any potential conflicts of interest are fully understood.

Late Day Trading and Market Timing

The allegations of late day trading and market timing are far reaching and involve multiple mutual fund companies, hedge funds, and the brokerage industry. Late day trading allegations involve mutual fund companies that allowed hedge funds, brokers, or other large investors to buy a mutual fund at the 4 PM price, after that time had passed. The advantage is that these traders could act on information after the close of the U.S. stock markets. So far, securities regulators have found several companies that allowed this practice and are still investigating others. Additionally, some companies have been accused of allowing short-term trading in to and out of their funds (market timing), even though this practice is not in the best interests of long-term shareholders and was often prohibited by the fund's prospectus.

What is MCM's policy toward mutual funds and fund companies that are charged in these investigations?

First, you can rest assured that we are following these investigations very closely, but they are broad and ongoing. As information becomes available, we analyze it to determine the appropriate response at that time and potentially in the future. We take these allegations very seriously, but we don't have a standard response to every situation. It depends on the problem, how pervasive it was, who was involved, who allowed it, and what the fund family intends to do about it. Our goal is to penalize the people who commit the transgression, not the fund or the fund family, which may have been working to prevent any malfeasance.