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The Investors 'Easy' Button

Nicole Garrison-Sprenger November 28, 2006

Diversify, diversify, diversify.

That's the sermon financial advisers have been giving investors for years. But diversification isn't as easy as it looks.

Investors can expend considerable time fine-tuning their portfolios to make sure they're capitalizing on changes in the market only to find that their portfolio zigged when it should have zagged.

Between 1984 and 2004, while the equity market generated an average return of 13.2 percent, individual investors achieved only a 3.7 percent return, according to a study by Dalbar Inc. in Boston.

"People chased the markets," said Andy Washburn, vice president and head of marketing for RiverSource Investments, a subsidiary of Ameriprise Financial Inc. in Minneapolis. "Their performance over time in doing that has not been

That's one reason more people are putting their money into mutual funds that invest in other mutual funds, otherwise known as funds of funds. At the end of 2005, assets in funds of funds totaled

\$261.9 billion, according to Morningstar. So far this year, the flow of assets into those funds has increased 63 percent to \$428 billion, while assets in all mutual funds grew only 13 percent during the same period.

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"People are moving existing money to the fund of funds," said Ryan Shannon, an investment adviser with Webb Financial Group in Bloomington.

Funds of funds, also called asset-allocation funds, enable individuals to diversify their investments between different types of assets — for example,

stocks of bonds — while enjoying the convenience of putting their money in just one place. And instead of trying to stay on top of trends and reallocate assets according to what's supposedly hot and what's not, the investment professionals at the fund families do it for them.

"These are ideal for the person who wants to hit the 'easy' button and doesn't want to be their own portfolio manager," said Patrick Egan, manager of asset-management marketing at Thrivent Financial for Lutherans in Minneapolis.

Thrivent is just one of the Minnesota mutual fund families that are capitalizing on this national trend.

First American Funds, the mutual fund family of Minneapolis-based U.S. Bancorp, is the most established local player, having introduced four funds of funds in 1996. First American established

a fifth in May 2006. Combined, the five funds had assets of about \$678 million as of Sept. 30, growing 16 percent over the past year. That's a faster rate of growth than the rest of the mutual funds in the family have seen, said Mark Jordahl, chief investment officer for First American Funds.

RiverSource launched its first fund of funds in 2004, and it has since grown to \$2.85 billion in assets. This year the financial-services company added two more funds of funds. Together, they've attracted another \$550 million.

"As performance of these products improves ... people are saying, 'There is an easier way for me to invest,'" Washburn, the RiverSource marketer, said. "They are willing to put more and more assets into these kinds of products."

In June 2005, Thrivent introduced four funds of funds. To date,

they've attracted \$1.4 billion in assets and have been among Thrivent's most successful fund launches ever.

Funds of funds are likely to attract even more assets in the future, thanks in part to the Pension Protection Act that President Bush signed into law in August.

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As a result of that law, beginning in 2008, eligible employees can be enrolled automatically in their employer-sponsored 401(k). Instead of opting in, as in the past, they'll have to opt out if they're not interested. Employers can choose a fund of funds as the default option.

Funds of funds may be convenient, but they aren't necessarily cheap. Each mutual fund charges a management fee. It stands to reason that a fund investing in other funds could get expensive.

"For people who are looking for a turnkey fund to take care of them, they may be willing to pay the higher expenses," Shannon, the Webb Financial investment adviser, said.

That said, investors who have committed to funds of funds may need to curb their appetite for investing in traditional mutual funds that focus on just one asset class.

Said Egan, of Thrivent: "People who don't get good guidance choose five different funds to invest in and if only one is an asset-allocation fund and then they buy a large cap (fund) and a small cap and some others, they are being redundant and (the fund of funds) is losing its value."