Mutual Fund Pollution [investment topic]

By Bill Ragsdale

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Mutual Fund Pollution. Investor Beware

Have you opened the newspaper to check on the current price of one of your Fidelity mutual funds and gotten onto the Fidelity Advisor and Fidelity Focus lists? Why so many? What are the letters A, B, C, I and T? Here is the inside story.

About thirty years ago no-load (no sales charge) mutual funds came into existence, inspired by the Vanguard family. Previously mutual funds were sold by brokers usually with a sales change of 8.5%.

The no-load innovation took the stock broker out of the process as there was no source of compensation. These funds were advertised in print and sold by mail. They reached full momentum in the 1980s. At that time the major national brokerage firms found that lowering sales charges from the common 8.5% into the 5% area was not sufficient to hold their customer base.

So they found some wiggle room in the SEC Regulation 12(b)1 which allows funds, with shareholder approval, to pay for marketing expenses, originally for printing and mailing of annual reports and prospectuses. The SEC then allowed sales commissions as an allowable expense. The brokerage firms could reduce or eliminate the initial sales change, advance the commission to the broker and extract it over time as a 12(b)1 charge to the fund. The fund could still be called "no-load" as the investor was not directly charged a sales fee.

Fidelity has several funds (including, for example, Balanced and Dividend Income) offered as pure no-load Fidelity Funds. Fund pollution comes from the duplicates which are offered as Advisor A, B, C, I and T. Class A is the same as the no-load verseion except the investor pays a front end sales charge. B shares have no front end load but carry a 12(b)1 fee. The C, I and T Classes carry various combinations of loads, fees and exit charges. The Fidelity Focus A, B, C and T are similar to the Select sector funds.

These variations allow the financial advisor to sell nationally advertised Fidelity mutual funds and find the cost which is least offensive to the client.

The dirty little secret about the hidden charges in the 12(b)1 fee is that, most often, the client pays more for the funds than if he just paid the load up front. The 12(b)1 fee is sliced out of the fund on a daily basis, 365 times a year. Neat and invisible to the investor. The charge does reduce the annual return relative to the pure no-load version.

One final irritation is that the Wall Street Journal has eliminated daily coverage of some of the smaller Select funds as they are space limited by the proliferation of new funds. Fund pollution is robbing us of complete coverage of the Fidelity Select family and many other smaller funds. Investors Business Daily still has full coverage.

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Bill Ragsdale has edited the Good Fortune advisory for eleven years, managed a mutual fund for three years and for 25 years was the CEO of an electronics manufacturer. He has an MS degree from the Stanford Graduate School of Business.