Do Lifestyle funds provide greater security?

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With the stock market stubbornly refusing to settle down and smooth out, Wall Street has been scrambling to come up with "product" they can sell to gun shy investors.

One such new concept is the Lifestyle fund; an extremely diversified package designed to be the single fund in an investor's portfolio.

There are two general types of these funds, in which assets are spread out across a wide range of stocks and bonds. In one, securities are held directly, in the other, assets are held through other funds.

Fidelity's Freedom 2030 is an example of the first type. It targets a specific retirement date, and the cash and bond stakes rise as that date approaches.

This type of fund has created a perception among investors that its value will not drop and that it is safe. But, in fact, these are no safer than a standard mutual fund.

Since we sold all of our investment positions on October 13, 2000 and preserved our capital, Fidelity Freedom 2030 has lost 39% (through 2/21/03). Do you think that's an isolated incident?

I'm not picking on Fidelity, but here are some of their other Lifestyle funds with returns over the same period:

Fidelity Freedom 2020: -34%
Fidelity Freedom 2010: -22%

So much for perceived safety.

The other Wall Street bright idea is the fund of funds (FOF). It sounds good, but it actually creates a double layer of costs; the cost of purchasing the fund itself, and then the expenses of the mutual funds the FOF purchases.

Take for example, the Enterprise Group of Funds. It shows an expense ratio of almost 2% plus a sales charge of 4.75% according to Morningstar. Tack on the underlying expenses and you're paying out more than 3% a year in investment expenses.

If you're a new investor (with less than $10k), and have your account at a discount broker, you can add a minimum of 1% per year in fees just for the privilege of having an account. That brings the total up to 4% in annual expenses. Talk about adding insult to injury.

FOFs are sometimes being touted as the only fund you need no matter what the investment climate. So, let's compare to see how the Enterprise fund of funds performed during the same period as mentioned above for the Freedom funds:

Enterprise Group of Funds: -35%.

The bottom line is that no matter what type of mutual fund you choose, or what anybody claims it will do for you, you must be vigilant and see if it does what you were told it would. In investing, there is simply no such thing as a sure thing. Sure you need to know how to recognize a good investment.

But just as important—maybe even more important—you must know when to recognize that a good investment idea didn't work out, cut your loss, and sell.

Ulli Niemann is an investment advisor and has been writing about objective, methodical approaches to investing for over 10 years. He eluded the bear market of 2000 and has helped hundreds of people make better investment decisions. To find out more about his approach and his FREE Newsletter,
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