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WINDOWS

Into the

Mutual Fund Industry

July 2008

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1H08 Perspectives

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- **US 1H 2008 highlights**: Intensified economic stress and 10% losses for the average equity fund. Yet, there was sustained demand for diversification through mutual funds, and a large number of fund managers, small and large, were still attracting new investments. Of the US fund industry's largest 100 long-term fund managers, nearly half experienced positive flows in 1H08 (1 in 8 each suffered redemptions of over 5% of assets).
- **Outside the US**: Fund investors in **Asia added over $100 billion in net inflows during 1H08** (led by strong gains in Korea, as well as inflows in India). **In aggregate, flows in Asia every month through May have been positive**. In contrast, in aggregate, European bond and stock funds experienced rising redemptions, albeit with matching inflows among cash funds. (1H net redemption out of European / off shore stock and bond funds equaled about 5% of assets; withdrawals were larger in Portugal, Spain, and Italy).
- **Profitability trends:** Pages 19-20 discuss the extraordinary (40%+) profit margins of investment managers (IM) during 2007. In aggregate, these IMs experienced similar profitability during 1Q'08 (vs. 1Q'07) (about half increased margins, about half reduced margins); in aggregate, 1Q revenues rose 8.0% while expenses rose 6.4%; 2Q'08 early reports show slightly lower profitability among some IMs.
- **Overall, US fund shareholder withdrawals are muted**: During January, despite a 10% stock market correction, equity funds net redeemed in aggregate about 0.5% of their assets. Redemption activity subsided after January, but was slightly elevated in subsequent months and spiked again in June when prices corrected rapidly. Yet, **the retreat in investor activity has been quite small given the magnitude of financial anxieties**, especially among middle-income investors (lately new long-term fund sales have run at the average pace experienced in 2007).
- **US equity fund flows in 1H:** Net flows into international equity funds fell from their torrid pace in 2007, and roughly matched net redemption from US-centered funds in 1H. **For US-centered actively managed funds, the very modest net redemptions in 1H—amounting to just 1% of assets—reflect the stable, retirement-oriented foundation of our industry**: **over 70% of all equity fund assets are intended for retirement savings**, and are mostly held in **buy-and-hold** retirement-type **accounts.**
- **US bond funds' 1H net flows neared $100 billion** (including VAs). Core bond fund use within asset allocation programs, and demand for TIPs, muni bonds, and international bonds helped propel flows.
- **US money market fund** flows are approaching $300 billion through July 2008, following the $630 billion volume last year (including VA-underlying MMFs).
- **US-registered international equity fund flows slowed in 1H. But we continue to believe that the secular desire of investors to diversify away their "home bias" is a strong, worldwide force, which, despite price corrections, will continue to drive demand for international exposure, somewhat counterbalancing negative sentiment overall.**
- **Asset allocation by default**: Rising focus on pre-packaged advice; transition from one-fund-at-a-time to "assembled" asset allocation grows. **US registered FoFs' 1H inflows neared $60 billion** (including VAs); all-in-one **global allocation** funds collected over $25 billion in 1H.
- **ETFs:** $26 billion in 1H 08 flows. Demand remains driven by institutions, but is also expanding among FAs, RIAs, and individual investors. 1H net flows were concentrated mostly among inverse ETFs (and others used for shorting), Latin America and selected Emerging Markets, and energy / agriculture sector ETFs. **Use of CITs has also expanded lately.**
- **SI continues to expand the range of services it offers**, including to over 70 of the most dynamic investment managers in the US, Europe, Asia, and Australia that are aspiring to grow globally. **Simfund Asia and Simfund Europe have been released—for the first time, business intelligence on the entire world of mutual funds is available through one platform.**
- **Simfund VA version 5.0 was just released:** it has major new content from **Lipper and Morningstar**, enhanced functionality, and **direct links to AnnuityInsight.com and the daily tracking of VA innovations**; it enables better tracking of sub-advisory opportunities and overall monitoring of the ever-changing VA business.

Trends in the First Half of 2008

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Fund Industry Overview
(Excludes ETFs and VA Underlying Funds)

	Net New Flows $B			
	2005	2006	2007	1H'08
US Equity	65.1	8.7	-35.5	-22.1
Int'l Equity	132.1	161.0	176.8	30.0
Subtotal Equity	**197.3**	**169.7**	**141.2**	**7.9**
Taxable Bond	28.4	48.2	94.1	57.3
Muni Bond	1.3	12.8	8.8	16.3
Subtotal Bond	**29.7**	**61.0**	**102.9**	**73.6**
Total Equity & Bond	**227.0**	**230.7**	**244.1**	**81.4**
Money Market	61.9	223.8	622.5	207.5
Total Industry	**288.9**	**454.5**	**866.6**	**288.9**

Source: Strategic Insight Simfund MF

During the second quarter, fund flows began to pick up; stock and bond fund flows were positive in June despite an 8% correction. Int'l / global equity funds (excluding ETFs and VA-underlying funds) saw inflows of $20 billion in April and May combined, while domestic equity funds took in over $8 billion during the same period.

On the heels of a strong 2007, **bond funds (excluding ETFs and VAs) have continued to pull in net flows at a healthy rate**, roughly $75 billion during the first half. The majority of those flows, about $57 billion, came into taxable bond funds. **Not surprisingly, inflation-indexed bond funds fared well, garnering $12 billion in the first half**, flows so far this year already exceeding the previous flow record set in 2004, when such funds amassed $9.6 billion over the entire year.

Money market funds extended their strong asset growth from 2007, as a result of the ambiguous market environment and additional repositioning of institutional assets away from credit-damaged vehicles. Year-to-date through June, MMFs garnered inflows of about $290 billion (after June's net redemptions, inflows resumed in July); the 2007 total equaled $620 billion.

With a sharp 8% correction for the S&P 500 during June, **the average equity fund investor saw a 10% decline** on an asset-weighted basis in 1H.

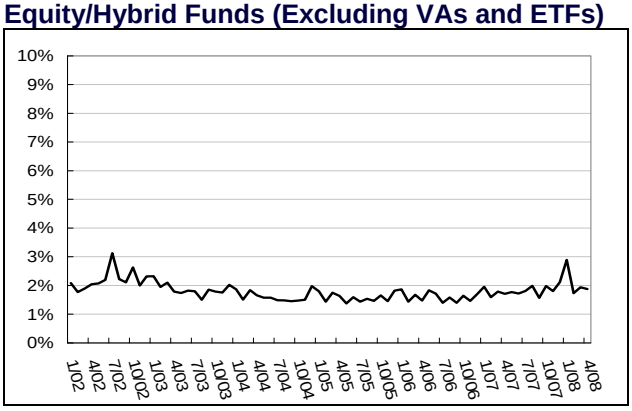
Average Asset-Weighted Annualized Returns %

	2005	2006	2007	1H 08
Domestic Equity *	7.1	13.7	7.0	-8.9%
Int'l Equity	15.5	23.6	15.5	-10.3%
Taxable Bond	2.4	5.3	5.5	0.3%
Muni Bond	3.4	4.9	1.4	-0.8%
Money Market	2.7	4.4	4.7	1.4%

** Includes hybrid/allocation funds. Source: Strategic Insight Simfund MF*

Financial pressures on middle-income investors, who anchor the fund industry, are rising. The real estate recession, food and transportation inflation and their many derivatives, employment concerns, and investment losses in 2008 have been widespread. Unsurprisingly, the pace of new equity fund investments has been slowing and redemptions spiked in January and in June (ICI's June data is not yet available). Yet, the redemption spikes, as was the case in January when the stock market fell 10%, were short-lived. Although slightly above prior periods, redemption activity remains modest.

Redemptions as a Percentage of Assets Equity/Hybrid Funds (Excluding VAs and ETFs)



Source: Strategic Insight Simfund TD (ICI Trends)

ETF purchases have slowed down so far in 2008. Inverse, sector (e.g., financial, used for shorting), and bond strategies dominated activity in 1H; diversified US equity ETFs experienced net outflows.

ETFs by Fund Type

	Net New Flows $B			
	2005	2006	2007	1H'08
Domestic Equity	24.3	35.5	88.5	14.5
International Equity	23.0	26.8	45.8	-0.6
Taxable Bond	6.3	5.1	12.5	9.3
Tax-Free Bond	--	--	0.6	0.9
Currency ETFs	0.1	1.1	2.2	2.1
Total ETFs	***53.7***	***68.5***	***149.7***	***26.2***

Source: Strategic Insight Simfund MF

Global Trends: EM Fund Flows Grow

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Emerging Markets Funds Absorbed $300 Billion in the Past Year—What's Next?

Will demand for emerging market investments, anchored by commodity prices, currency considerations, and higher strategic asset allocation to EM wealth continue despite the recent price correction? Or, will EMs experience a recurrence of capital flights and price depreciation as happened in prior investment cycles?

More than $20 billion in net flows around the world went to funds investing in "emerging market" (EM) stocks during April, with most of the new money contributed by investors across Asia and Europe. Asia-domiciled EM funds drew $8 billion while Europe-based and cross-border international EM funds absorbed a similar amount, with significant portions of each of these amounts sourced in Asia. US-based EM funds garnered $4 billion. Preliminary data for May suggests another strong result with around $10 billion in EM flows outside the US (versus $16 billion in April). We expect flow data for June to show some trend reversal, as a result of the 10% average drop in the NAVs of US-registered EM funds during the month. And there has been further correction in July.

[In Strategic Insight's analysis, EM funds include diversified, regional (Latin America, Asia Pacific excluding Japan, Emerging Europe), and country specific funds (China, Korea, India, etc.).]

In all, EM funds soaked up more than $300 billion net over the past 12 months through April, according to SI's Simfund Global databases, which track funds with collective assets under management of nearly $25 trillion worldwide. This includes $60 billion to diversified programs across Asia, Europe, and Offshore. But the greater part represents country funds such as China, Korea, and India, which together absorbed $200 billion, primarily from investors in those countries. US investors channeled nearly $30 billion to EM funds over that 12-month period.

Most flows in the past year went into China and Korea stock funds, but other segments, such as Middle East, "new emerging" and "frontier" strategies are also benefiting (see discussion on New Fund Success in this area in the US, on page 6).

Positive flows in early 2008 into EM funds contrast sharply with outflows from other categories, especially $140 billion in net redemptions from funds investing in Europe over the past 12 months. And the remarkable EM fund gains do not include rising pension fund allocations through mandates, and rising allocations to EM within broader global equity programs.

Equity Funds by Category, Net Flows $ Billion across Asia, Europe, Offshore; excludes US

	4/08	Trailing 12 Months
Equity Emerging Markets	4.8	47.8
Equity China	2.9	133.9
Equity Korea	2.3	52.3
Equity Asia Country	1.9	16.1
Equity India	1.6	14.6
Equity Latin America	1.4	14.9
Equity Asia Pacific Ex Japan	0.9	9.9
Equity Russia	0.4	4.2
Total Emerging Market Above	**16.3**	**293.8**
% of Total Equity	**89%**	**158%**
Equity Europe strategies*	2.1	-139.3
Other Equity (ex EM, ex Europe)	-0.1	31.8
Total Equity Funds	**18.3**	**186.3**

**Excludes Russia funds but includes other European country and diversified strategies; April inflow to Europe Country mostly ETFs. Source: Strategic Insight Simfund.*

The EM equity story is closely related to the **ongoing growth of mutual funds across Asia**, another dominant theme for our industry. **Investors across Asia-Pacific placed $100 billion net into mutual funds during 2008 through April. April flows were meaningful with nearly $40 billion in net inflows into local funds in Asia (led by Korea and India).** Flows in Asia every month through May this year have been positive, despite market uncertainties.

EM: Matching Capacity to Demand

The sales going to EM equity funds, in addition to having a growing impact around the world on liquidity, stock prices and volatility, has also led to fund manager capacity constraints.

The strong inflows over the past year partly represented "performance chasing", and in other cases "promise chasing"; in reality, many investors (and strategists setting asset allocation guidance) are looking to emerging markets as long-term sources of portfolio diversification, high returns, and alpha. **With EM a structured sleeve in many investors' asset allocation, some sustained demand may counter-balance likely withdrawals by some return-chasing investors.**

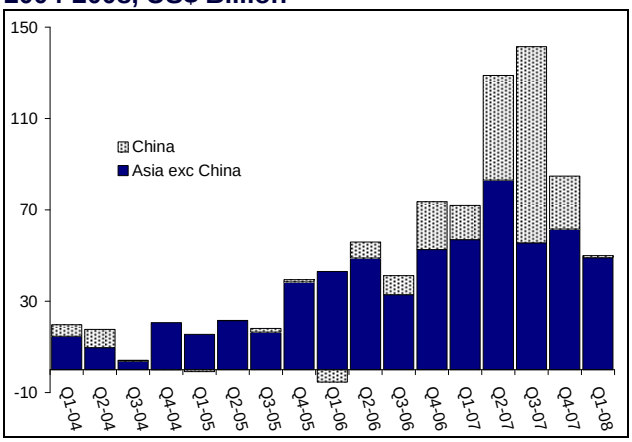
However, many managers are admitting severe EM capacity constraints, and are either closed or closing to new investments, or are not actively promoting their funds. Many well-known managers with substantial assets in EM products (both mutual fund and institutionally) are also the ones favored by consultants, making the capacity issue particularly acute for pension funds.

This is no surprise, since a **disproportionately large chunk of diversified EM flows has gone to fewer than 60 products with more than $1 billion in assets each (representing just 6% of the total universe). This extreme minority collected $22 billion in the twelve months through March—**nearly half of net flows of all diversified EM (ex Latin America) during the period.

Asia on Track in Early 2008

A total of $94 billion flowed into Asian mutual funds in the first four quarters of the year, $72 billion of which went into long-term funds.

Asia*: Quarterly Long-Term Fund Net Flows 2004-2008, US$ Billion



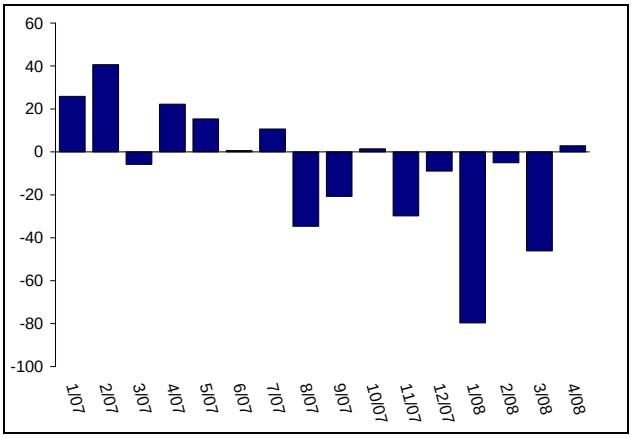
**Local funds and selected offshore funds sold exclusively in Asia; excludes cross-border international funds sold worldwide; excludes Australia. Sources: Strategic Insight Simfund Global; Lipper, Inc.; Morningstar, Inc.; Industry Associations.*

China-domiciled funds captured $1 billion in inflows in Q1, a modest but very significant and encouraging result given NAV declines and other challenges as of late. Twelve new portfolios in China raised more than $7 billion during the first quarter, with more than 70% going to bond mutual fund vehicles. (Details available in SI's Asia FlowWatch report.)

Nearly 40% of flows in Asia went to bond funds and almost 30% to equity products this year. One-quarter went to money market programs. Allocations at least regionally are thus fairly diversified, providing opportunities for many managers.

Europe: Modest, Temporary Relief from the Negative Trend

Europe: Monthly Long-Term Fund Net Flows € Billion

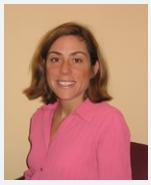


Source: Strategic Insight Simfund Global; Lipper, Inc.; Morningstar Inc.; Industry Associations.

Flows Turn, in Part: Europe, including cross-border international, was modestly flow-positive during April, offering a breather from the seemingly relentless trend of recent outflows (June NAV declines triggered recurring outflows). Equity funds during the month gained €10 billion net, heavily influenced by re-allocations to a few ETFs (ETFlab DAX with €4 billion, XMTCH on SMI with €2.4 billion, and iShares DivDAX with €2 billion). Money funds pulled inflows, but other categories including bond funds remained in net redemptions. Preliminary data for May suggests similar overall flow trend and levels in May, although there has been deterioration since.

Year-to-date through April, money market and liquidity programs in Europe and Offshore collected over €100 billion net, against €140 billion in net redemptions from long-term products. Despite the aggregate outflows, **many individual funds are still advancing as investors rotate into funds with strong track records and ratings, new ideas, and promising themes.**

Frontier EM Fund Development; Recent New Fund Successes



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Frontier Emerging Market Funds

"Frontier" emerging markets are attracting increasing interest from US investors and fund companies for their potential diversification benefits. Funds dedicated to investing in such "beyond the mainstream EM countries" have also been used as plays on commodities (as the growth of some of the frontier markets, especially some in Africa and the Middle East has been commodities-led) and on the US dollar. Frontier EMs are typically small, illiquid, less-well known, and less accessible, with less-developed (but in the process of liberalizing) regulatory regimes. Until the last couple of months, **T. Rowe Price's Africa and Middle East fund** was one of the only ways in which retail investors could access this asset class. That fund, which itself was only started last September, has garnered nearly $800 million in net flows since its inception; an institutional version of the fund started in April has captured an additional $82 million. **Fidelity** started the **Emerging Europe, Middle East and Africa fund** in "advisor" and direct-sold versions this May. Then **Claymore** started the first frontier markets **ETF** in June (Claymore/BNY Mellon Frontier Markets ETF), followed by **PowerShares' MENA Frontier Countries Portfolio** and **WisdomTree's Middle East Dividend** in July. **SSgA** and **Van Eck** are also readying frontier markets ETFs, including some offering exposure to such markets in particular regions or based on individual frontier markets: such as GCC Middle East and Vietnam. And **Morgan Stanley** plans a closed-end fund offering frontier EM exposure.

Notable New Open-End Actively Managed Funds

The table below lists actively managed open-end funds started over the trailing one year that have raised $75 million or more over the trailing three months. Only three **US-centered funds** appear in the list: a fund from **PIMCO** that uses derivatives to obtain long exposure to the Enhanced RAFI 1000 and short exposure to the S&P 500, keeping roughly equal value exposure in its long and short positions; and backs the long-short investments with an actively managed fixed income portfolio; a quantitative enhanced-index approach from **TIAA-CREF**; and a fund from **Northern Trust** employing multiple external managers for the large-cap space. Among **international equity funds**, the list includes a rare product line extension from Dodge & Cox that has the flexibility to invest in the US and abroad, emerging / "frontier" markets / infrastructure funds, global tactical allocation (opportunistic allocation across multiple asset classes and currencies or "unconstrained benchmark" approaches) and quantitative strategies. Among new FoFs that investors found appealing was a three-in-one type offering, managed payout funds, alternative strategy allocation, and a tactical allocation fund-of-ETFs.

Actively Managed Long-Term Open-End Funds Started since 5/07 with Highest Trailing-3 Month Flows

	Assets 5/08	Net Flows, $MM Trailing, as of 5/08 12 Mth	3 Mth
Domestic Equity			
PIMCO FndmtlAvtg Tot Rtn	516	522	**522**
TIAA-CREF IL En LgCpGr Idx	109	106	**84**
Northern Multi Mgr Lg Cap	314	305	**76**
International Equity			
Dodge & Cox Global Stock	272	272	**272**
Price Africa & Middle East	853	779	**229**
Old Westbury Global Opport	1,698	1,683	**216**
GS Structured Intl Tx Mgd Eq	141	139	**131**
ING Tactical Asset Allocation	120	118	**118**
GS Structured Emerg Mkt Eq	128	117	**117**
TA Schroders Intl Small Cap	147	102	**102**
Steward Global Equity Inc	89	87	**87**
TIAA-CREF IL En Intl Eq Idx	119	119	**86**
Price IL Africa & Middle East	82	82	**82**
Kensington Global Infrastctr	227	223	**81**
MFS Diversified Target Retrn	133	130	**79**
Taxable Bond			
DFA Select Hdgd Glb Fxd Inc	204	205	**180**
JHF II Floating Rate Income	394	387	**109**
Funds-of-Funds			
Hartford Checks & Balances	856	846	**305**
DWS Altern Asset Alloc Plus	355	345	**178**
Lazard CptlAlloc Opp Strtg	161	157	**157**
Vanguard MngdP Gr & Distr	110	109	**109**
FundX Tactical Upgrader	112	107	**107**
Vanguard MngdP Distrb Fcs	77	76	**76**

Source: Strategic Insight Simfund MF

International Funds: 1H 08, and Ahead

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US-Based International/Global Equity Mutual Funds $ Billion

	Assets	Annual Net Flows				
Structure/Type	**5/08**	**'04**	**'05**	**'06**	**'07**	**1H'08**
Open-end Active	**1,634**	**79.0**	**116.9**	**146.9**	**139.9**	**23.8**
Open-end Indexed	97	5.4	8.5	11.3	17.5	6.2
ETFs	181	15.3	23.0	26.8	45.8	-0.6
Closed-End	50	4.4	6.7	2.7	19.4	0.0
VA Funds	216	9.7	12.9	22.1	20.7	2.3

Source: Strategic Insight Simfund MF / VA

International / Global equity funds now account for about 30% of US investors' equity fund asset allocation (up from just 10% five years ago). Similarly, about 30% of equity funds *sales* in the past year went to international / global equity funds. So far in 2008, the US fund industry has seen a repeat of a pattern exhibited in recent years—net inflows into international/global equity mutual funds have surpassed those into domestically invested equity funds (flows into domestic equity funds have actually been negative lately). Lingering concerns about the US Dollar's long-term prospects and US economic leadership are common. And some US wealth managers are recommending higher international allocations more in line with the US share of global capitalization (under 50%, and declining).

We have hypothesized before that **more and more investors are coming to the realization that in a "Flat World" for wealth creation, prudence dictates a greater exposure to intellectual capital outside the US, especially for very long-term oriented retirement portfolios.** This suggests that the interest in investing abroad goes beyond the cyclical nature of investors chasing yesterday's winners, and that the **desire for worldwide diversification is here to stay. If we are right, this secular demand should serve as somewhat of a buffer during future periods of falling absolute and relative returns for international funds**, including during a modest appreciation cycle for the US dollar.

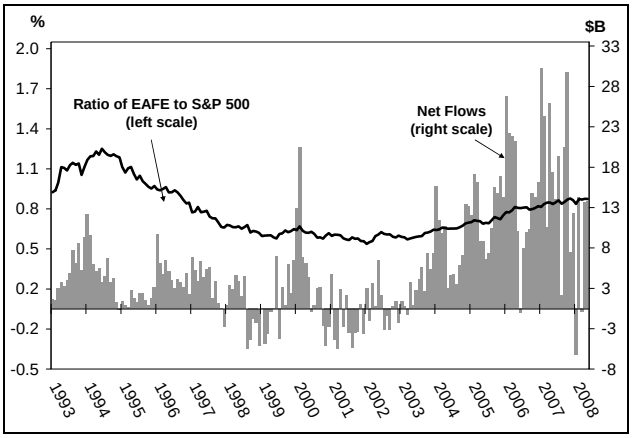
Int'l Equity , US Equity, and World Bond Funds Annual Average Total Returns (Asset-Weighted)

	'03	'04	'05	'06	'07	1H'08
Int'l/Glb Eqty	36.27	17.83	15.47	23.61	15.52	-10.31
U.S. Equity*	30.76	11.99	7.49	13.82	7.08	-9.15
World Bond^	12.83	8.33	-1.56	6.42	8.58	2.44

*Source: Strategic Insight Simfund MF; * Exc. Balanced/Hybrid, Funds of funds, ^ Morningstar category.*

Flow trends, and the relative performance of the MSCI EAFE vs. the S&P 500 Index are captured in the chart below.

Relative Performance of US v. Foreign Stocks and Net Flows into Int'l/Global Equity Mutual Funds



Source: Strategic Insight Simfund, Standard & Poor's

By Investment Style: Net Flows and Assets

Actively Managed International/Global Equity Funds 10 Highest Ytd-5/08 Net Flow Classifications

	Net Flows $B		Assets $B
	2007	**1H'08**	**6/08**
Global Multi-Cap Value	20.9	5.3	139.5
Intl Multi-Cap Growth	25.5	4.4	253.9
Emerging Markets	7.4	2.8	132.4
Intl Large-Cap Core	5.3	2.3	87.2
Gold Oriented*	0.2	1.2	23.1
Latin American	1.2	1.2	13.9
Intl Small / Mid-Cap Value	2.8	0.5	13.4
Global Multi-Cap Growth	1.8	0.4	7.5
Intl Large-Cap Growth	-1.0	0.0	22.0
Japanese	-1.5	0.0	3.7

Excludes index funds and ETFs, as well as VA funds
** Investing mostly in non-US stocks.*
Source: Strategic Insight Simfund MF; Lipper Inc. (Classifications)

Rule 12b-1: Next?

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What direction will the SEC's proposed changes of Rule 12b-1 take? **It is our current understanding that the SEC is considering the restructuring of Rule 12b-1 along the following lines**:

- All changes to be prospective; fees within accounts established prior to the new rule will continue in place.
- A portion of fees, generally 0.25%, used as a trail fee to enable financial advisors to maintain and service accounts, to be renamed ("shareholder servicing and distribution-related administration fees?") **Such fees would be permitted to be charged without any time limitations, i.e. as long as the assets are invested in the share class.**
- **Beyond the 0.25% "shareholders servicing fees", any additional fees currently charged under Rule 12b-1** (and generally used as direct or indirect sales compensation for financial advisers) **would be treated as if they were "asset-based sales charges." Consequently** (following NASD/FINRA sales cap calculations and guidance), **such fees will be limited in duration.**
- For each new purchase of a share class where currently 12b-1 fees exceed 0.25% (such as "Bs" or "Cs"), the amount exceeding 0.25%, now called "asset-based sales charges," would be permitted to be levied only for a limited time—only until the cumulative fee ratio charges match, for the same fund, the maximum "A" share front-load.
- Examples: a fund has an "A" share class with a maximum 3% point-of-sales commission. It also has a "D" share class with 0.75% 12b-1 fees. In this case, 0.50% "asset-based sales charges" (0.75% less 0.25%) would be charged annually to the investor in the "D" class for a period not exceeding six years (0.50% x 6 = 3%). Or, if the "A" share maximum front-load is 5.25% and same fund's "C" currently charges 12b-1 fees of 1.00%, the investors in that "C" class could be charged 0.75% for seven years (0.75% x 7 = 5.25%). At the end of seven years (the 85th month of holdings), the assets in that "C" share would convert to a share class with no "asset-based sales charges" (similarly to "Bs" which automatically convert after a pre-set number of months). It is not clear to us if the SEC will take the time value of money into consideration in such computations.
- If a fund company does not offer "A" shares, the conversion period for the "C" shares could possibly be tied to the FINRA caps. It was suggested to us that it is also likely that the FINRA Cap rules will need to be revised as part of the SEC modification of Rule 12b-1.
- Unlike the current requirement regarding periodic review of Rule 12b-1 fees, directors will have no stand-alone approval requirement for the new "service fees" and the "asset-based sales charges" under the amended Rule 12b-1.

Some Implications of Proposed Changes to Rule 12b-1

Investors: Some investors would be helped; others may be disadvantaged over time, as discussed below. After seven or eight years, if the investor still owns the same fund's "C" share class, the class will auto-convert to an "A." Yet, the fee-reduction in "C" share classes would help the small percentage of investors in "Cs" that hold the shares beyond its auto-conversion period (often used by FAs as substitute to fee-based accounts). We hypothesize that at the time of auto-conversion, possibly about **one-third of the original shares purchased (naturally higher in value due to appreciation) would still be held in the account, with the balance already having migrated to funds of other companies, or switched to other share classes within the same fund family.**

Inevitably, many FAs would accelerate their use of fee-based accounts (instead of "Cs"). [As discussed in SI's study of Rule 12b-1 published last year, we believe that investors' total costs in fee-based accounts (paid with after-tax dollars) are higher, in most cases, than fund costs that include 12b-1 fees.]

Fund directors: If 12b-1 fees are limited to a 25 basis points "safe harbor" that can be used for distribution or service, and "asset-based sales charges" made equivalent to sales loads, directors would no longer have to monitor and review this issue subject to Rule 12b-1 and its factors. Instead such "renamed" fees

would become part of directors' periodic reviews of overall expenses and sales charges (**if the new rule is adopted in the form we've outlined here, we do expect substantive revisions and alignments of point-of-sales charges** and other modifications of shareholder costs, necessitating Board reviews; see rationale below).

Financial advisors: Some financial advisors (FA) using "Cs" (as a convenient and shareholder-advantageous substitute for fee-based accounts) may be encouraged by their BDs, or may choose on their own, to abandon "C" classes and **substitute** these **with fee-based accounts using NAV share classes (in NAV share classes no caps based on holding periods are in place**, as the asset-based fees are imposed outside the fund structure).

"A" share classes (with point-of-sales commissions): Under the proposal being considered by the SEC, as per our understanding, assuming identical holding periods, projected cumulative "asset-based sales charge fee ratios" on "Cs" would, by design, always add up to less than, or the same as, those under "As" for which the maximum point-of-sales commission is charged. However, this calculation does not account for the timing of fees, or for the compounding effect of fees charged on appreciated assets, the latter driving higher cumulative fees in dollars for "Cs."

Because of the added complexity involved for FAs evaluating the hypothetical costs of "As" vs. "Cs" over multi-year investment horizons, the uncertainty of holding periods, and financial market performance, BDs would have to issue new guidance on how to compare the projected costs of share classes. Possibly, **such guidance may be easier to follow and implement if offered by FINRA, instead of separately by each BD**.

Because the duration of asset-based fees for "Cs" will be calculated vs. the "maximum" point-of-sale commission on "As", **fund managers may modify the break-point commission structure of their "As".**

Some funds may introduce steeper commission discounts (breakpoints) **at lower dollar purchase** (or subject to right-of-accumulation) to encourage "A" purchases (when the discounted load would make this choice more desirable than "Cs" in buy-and-hold accounts). Conversely, some managers may modify the commission schedule of their "As" to encourage greater use of "Cs." (Through SI's SimfundFiling.com's daily tracking of any such changes filed with SEC, we will be in a position to monitor and inform on such adjustments.)

Note that, as captured in SI's recent survey (See *Executive Insight: Fund Managers Focusing on Intermediary Sales*), during 2007, "A" shares sold at maximum sales loads accounted for less than 10% of total BD sales (with additional sales at discounted loads); "Cs" controlled one in 8 dollars sold; and sales of shares at NAV commanded nearly 60% of all sales, showing that fee-based relationships already dominate.

"Bs:" It is not clear if the fee change makes "Cs" always better than "Bs" (since both will have identical conversion periods, but "Bs", due to their contingent deferred sales charges (CDSC), appear almost always to be more expensive than "Cs"). Also, rule change and ensuing modification needed in the treatment of "B" shares' 0.75% asset-based sales charges would trigger changes in the current conversion periods of "Bs" for virtually every "B" fund, and subsequently, its literature, sales guidance, and back-office technology.

With the already tiny and falling use of "Bs" ("B" shares accounted for just 2% of sales in 2007), **many fund managers** would conclude that this is an opportune time to discontinue offering "Bs." **BDs may just stop selling "Bs"** to avoid the potential of selling "Bs" inappropriately instead of "Cs," as well as new technological investments to monitor revised "Bs" and added due diligence.

"Cs:" What would be the rules for intra-family switching activity (between an equity fund with 0.75% asset-based sales charges and a bond fund from the same family levying 0.50% in such fees?); or across fund families? What would the conversion period for a fund company that does not offer a dual "A" class be (does one calculate based on NASD/FINRA Cap rules?) (Also, it's not clear how assets switched from pre-rule change "C" accounts would be handled; and, should the new limited-duration "Cs" be renamed to differentiate them from the pre-rule change "Cs,"—e.g., "C-O", vs. "C-N"?; if so, an investor may end up with C-O and C-N, B-O and B-N, R-O and R-N positions, etc.?)

"Rs: Industrywide, there are about $80 billion in assets held in dedicated retirement-share classes charging 12b-1 fees of over 0.25% (about two-thirds of these assets are within funds sponsored by American Funds). In such funds, 12b-1 fees are used to enable the

servicing of smaller, expensive-to-administer retirement plans. The impact of Rule 12b-1 changes on "Rs" is unclear, as cost-sharing with the DC plan is required in perpetuity. Possibly, such needed cost-sharing fees may be renamed and restructured so they continue to be available for smaller DC plans, and would not be subject to a limited duration, a particular problem for retirement accounts where investors should buy-and-hold for 20 or 30 years. The tiny amounts involved in dollar-cost-averaged DC investments make "Rs" a particular challenge if conversion periods have to be calculated and applied.

The necessity of greater definitional clarity with regard to the reconfigured fees, owing to liability concerns of fund managers: How is "shareholder servicing" defined, what is an "asset-based sales charge," and how do these relate to other charges that cover plan administration expenses in classes like the "R" shares—the boundaries have to be clarified to avoid unintended liabilities.

An administrative and due diligence challenge (nightmare?) for distributors: Commonly at many fund complexes, the maximum load on equity funds' "As" is higher than for bond funds' "As". Thus, buying equity fund "Cs" mandates a certain conversion period; buying bond fund "Cs" mandates a shorter conversion period; what happens when a shareholder switches from a bond fund "C" to an equity fund "C" within the same family? Would managers need to modify the load (and the renamed "asset-based sales charges") to be identical across all funds—equity, long-duration bond, short-duration bond?

What about investors or FAs switching from one manager's "Cs" to another manager's "Cs" two years after the original purchase—will the conversion clock start anew for them? How about switching just one month before the auto-conversions? How can a BD pass judgment about appropriate or inadequate switching? We remember that many BDs practically gave up on "Bs" once ensuring perfect breakpoint compliance (discounted "As" vs. "Bs") became a focus of NASD enforcement actions.

Given the increasing complexity, BDs would push for uniformity across fund firms in sales loads, conversion periods and nomenclature, and for the elimination of "idiosyncratic" share classes in order to have fewer pricing models, especially in the retail world.

At its extreme, the technological complexity and never-ending due diligence concerns about re-designed "Cs, Bs, As, and Rs" could result in many BDs giving up on traditional share classes and instead accelerating transition to fee-based accounts where no caps are in place. The externalized fees such a transition would bring are flexible and customizable, but also tax-inefficient, somewhat opaque, and inherently impossible to benchmark across BDs. Under BDs' total control, such fees, especially for low- and middle-wealth investors, may remain higher than fees-for-advice currently paid under Rule 12b-1.

Retirement Income Innovation: Open-End Managed Payout Funds

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Over the past year or so, a number of firms have launched open-end mutual funds looking to create predictable (but not guaranteed) payouts for those already in retirement and for pre-retirees nearing retirement, through, in most cases, diversified hybrid / asset allocation portfolios. Most of these products are not intended as the sole, turnkey solution for an individual investor's retirement income portfolio but as part of a larger asset allocation model. The sponsors of these funds expect the flexibility and control they offer to appeal to those disinclined to annuitizing their assets. Unlike annuities, these funds offer the daily liquidity and other attributes that are part of the open-end design.

Many closed-end funds have already offered "managed distribution" policies targeting 8%-10% distribution rates in recent years, though also without offering any of the guarantees that come with insurance-wrapped products. Demand from income-centered investors helped such CEFs' liquidity and in reducing their discounts to NAV. But the fact that in turbulent market environments, the high distribution yields may prove unsustainable and have to be cut, exacerbating discounts relative to share prices, has limited the attractiveness of such CEFs.

The first generation of open-ended managed payout funds that has come to market features different permutations of asset management and distribution strategies. Most are structured as affiliated funds-of-funds, with underlying funds from various asset classes, some including non-traditional ones, for additional diversification.

Some are "perpetual" offerings (such as those of Vanguard, Schwab, John Hancock, Baron, ING), **while others offer a choice of fixed terms**, with some of the shorter terms having the potential of being used as "bridge" solutions to cover an income gap between one event and another, such as between an early retirement and the beginning of social security payments, or a time that DC plan assets can be accessed without penalty, with a "lifetime" strategy chosen at the end of the bridge period. One way in which some of the sponsors are positioning the funds towards retirees and pre-retirees is as a means of funding "discretionary" retirement expenses, such as those for travel, gifting, and entertainment (or the investors' "lifestyle") with essential expenses, structured with more secure income, like pensions, social security, a high-quality bond ladder, etc.

Payouts are not guaranteed (except in a CPPI-based offering from DWS Scudder also highlighted in this article), so they can vary depending on market returns—they consist of dividends and interest, short and long-term capital gains, and as is the case with managed distribution closed-end funds, may include a return of capital. Some of the funds in this category explicitly draw down principal, others seek to preserve or even grow capital, in an attempt to meet not just the ongoing cash flow needs of investors but also their precautionary or bequest goals—of course, whether funds with the latter secondary goal can avoid returning capital without cutting payouts will depend on investment performance. Some are structured to distribute a percentage of assets—so the dollar value of payout will fluctuate based on fund performance (payout rates range from 2-4% in the more aggressively-invested funds to 6-7% in more conservative funds); others seek to essentially pay out a fixed dollar amount per share per year. Initial investment minimums in the retail share classes range from $100 in Schwab's offerings to $50,000 in John Hancock's two Retirement Distribution funds.

Open-end payout funds also differ in the frequency of distributions offered, the range being from monthly all the way to annual, with monthly being the most common, given the greater appeal of a monthly check (Behavioral finance suggests such an approach might be preferred, especially by older investors; funds naturally need to address the regulatory restrictions relating to more than one long-term capital gain distribution in a year, possibly addressed through the use of an affiliated money market fund for distributions.)

Highlights of some of the open-end managed payout funds currently in the marketplace follow.

Fidelity's "Income Replacement" Fund Series

One of the first in the category to come to market, Fidelity's Income Replacement series was launched in August 2007. The series looks to offer a time horizon-based retirement income solution that is complementary to other methods such as annuities, bond ladders, etc. The funds have asset-allocation models set by target liquidation date, ranging from 2016 to 2042, with a fund at each two-year interval. Each of the 14 funds in the series allocates to underlying Fidelity funds based on an allocation strategy, which like that of target-date funds designed for accumulation, grows progressively more conservative over time.

The payout strategy of the funds is implemented through an **optional account feature designed to enable shareholders to receive regular monthly payments that potentially keep up with inflation, and result in the liquidation of the fund by its horizon date.** The monthly payments come from the earnings of the fund plus as much of the principal as is necessary and are computed based on a **schedule of annual payout rates targeted over the funds' 10- to 35-year time horizons**. The payout rates for a fund **increase annually**, building towards a 100% payout in the final year; the longer the time horizon, the lower the initial payout rate. The annual payout rates are applied to fund NAVs at the end of the previous calendar year, to yield the **annual dollar payment per share**, which is then paid out in 12 equal monthly installments.

Equity allocations for the funds at the end of May ranged from 63% in the fund with the furthest horizon (2042), to 36% in the fund with the nearest target-date, the 2016 fund, according to Morningstar data; the remainder of each fund's assets was invested in bond and money market funds. Besides traditional stock and fixed income underlying funds, the FoFs allocate 5% to 7% of assets to the hybrid Fidelity Strategic Real Return fund, which invests in TIPS, floating rate loans, commodity-linked, and real estate investments.

Available in direct-sold and advisor-sold versions, the Fidelity Income Replacement funds held $42 million in assets at the end of June; three-quarters of the $20 million in new cash flows year-to-date have gone into the four nearest target-dates—2016 to 2022, and the 2028 fund, all having horizons of 20-years or less.

Vanguard Managed Payout Funds

In contrast to the approach of Fidelity's Income Replacement funds, **Vanguard's** three **"Managed Payout"** funds started this April are "perpetual" offerings that **seek to preserve or build capital over the long term** while providing level monthly payments throughout each year, with the **annual payouts adjusted each January based on a fund's performance over the prior three years**. Investors can opt for a 3%, 5% or 7% annual payout depending upon whether their focus is on greater income or capital appreciation. Taking a three-year average account value is expected to enhance the relative predictability and stability of distributions from year to year and allow for planning on an annual basis. Until the funds have established three calendar years of history, a modified version of the formula will be used.

Each Vanguard Managed Payout (MP) fund may invest across multiple traditional and alternative asset classes—such as stocks (including real estate securities), bonds, cash, inflation-linked, and selected other investments, such as commodity-linked and market-neutral, and potentially in a "prospective absolute return fund" that Vanguard may start and run that would not be registered as a mutual fund. (Stock and most bond investments would be made through indexed Vanguard funds.)

Vanguard Managed Payout Funds

	Target Annual Payout %	Asset Allocation as of 6/08		
		Stocks	Bonds	Short-Term Reserves
Growth Focus	3%	85.6	10.0	4.4
Growth & Distbn Focus	5%	75.1	20.2	4.7
Distribution Focus	7%	70.0	25.1	4.9
Total				

Source: Vanguard

Each of the MP funds had a 10% allocation to the Vanguard Market Neutral fund as of the end of 6/08.

The MP funds' prospectus compares them to endowments in that they seek to generate regular monthly payments while trying to preserve their capital over the long term, and also because of the wide spectrum of asset classes and investments that each fund may invest across, which the manager expects will add diversification and result in a more consistent return pattern than a traditional balanced portfolio. [Over the last decade, college and university endowments have gradually shifted assets out of conventional equities and fixed income and into alternative investments. According to the 2007 NACUBO Endowment Study, college and university endowments allocated nearly 20% of their assets, on average, to non-traditional asset classes (commodities, private equity, hedge funds (including strategies such as long/short), and real estate), up from less than 7% in fiscal year 1998.

Among endowments with assets greater than $1 billion, a much higher 40% of assets were allocated to alternative asset classes, on average, at the end of FY 2007.]

Vanguard has reportedly applied for a patent for various operational aspects of its payout funds, which held $277 million in assets at the end of June, with roughly half those assets residing in the 5% target payout fund. (See page 22 of this report for an update on business method patents.)

Schwab Monthly Income Funds

Schwab's suite of **Monthly Income (MI) funds** started this March features three funds, each targeting different annual payout ratios (see table below). Like the Vanguard offerings, the MI funds aim to preserve and even grow rather than distribute original investment.

Schwab Monthly Income Fund Series

Fund	Target Annual Payout*	Anticipated Annual Payout* In Low Interest Rate Envrnmnt	Anticipated Annual Payout* In High Interest Rate Envrnmnt
MI - Moderate Payout	**3-4%**	2-4%	3-5%
MI - Enhanced Payout	**4-5%**	3-5%	4-6%
MI - Maximum Payout	**5-6%**	3-5%	5-8%

** As a percentage of average fund NAV over preceding calendar year. Source: Schwab*

According to the funds' prospectus, the "target" payout rates are based on historic yield environments over a ten year period, and a fund's actual annual payout could be higher or lower than the "targeted" level based on the interest rate environment and other market factors during that year. It warns that lower annual payouts can be expected in a low interest rate environment (such as the current one).

The Schwab MI funds will watch the flow of dividends generated by underlying investments, which are for the most part traditional (affiliated actively-managed domestic and int'l stock funds, active and indexed bond funds, and MMFs), in an attempt to "smooth" or reduce volatility in monthly income payments, but the amounts distributed may not be the same each month.

Although the MI funds are designed with the expectation that the monthly payouts will be paid in cash, investors will be asked to choose from three distribution options (reinvestment, cash/reinvestment mix, cash only) with respect to the dividends and capital gains paid out.

The following table shows the broad "target" asset allocation ranges the funds have the flexibility to move within, as well as June-end actual allocations. The most aggressive of the three MI funds—the Moderate Payout one—had a stock allocation of about 40% as of June 30th, 2008, with the emphasis being on dividend-focused and global real estate equity investments. The single underlying fund to which each of the MI funds devote the biggest chunk of assets is the **Schwab Premier Income**, a yield-focused, recently-started Schwab offering with a flexible mandate that allows it to go beyond traditional bonds and CDs into income- and non-income producing equities from around the world (currently, the Premier Income fund is entirely invested in bonds/cash).

Schwab Monthly Income Fund Series

Fund	Target Allocation Ranges: Equity	Target Allocation Ranges: Fixed Inc & M-Mkt	Allocation as of 6/08: Stock	Allocation as of 6/08: Fixed Inc & M-Mkt
MI - Moderate Payout	20-60%	40-80%	**39%**	**61%**
MI - Enhanced Payout	10-40%	60-90%	**24%**	**76%**
MI – Maximum Payout	0-25%	75-100%	**9%**	**91%**

Source: Schwab

Russell's Target Distribution Strategy Series

"Manager-of-managers" **Russell Investments** seeded three **Target Distribution Strategy** funds-of-funds at the end of December last year and went live with them in April. These **fixed-term** funds, which are targeted to advisors, seek to provide a particular **dollar payout annually**.

Russell Target Distribution Series

Fund Name	Term (Yrs)	Initial Payout/ share/yr*	Equity Allocn† 5/08	Preservation of capital as Secondary objective
2017 Retirement Distribtn	10	$0.70	100%	Yes
2027 Extended Distribtn	20	$0.60	33%	Yes
2017 Accelerated Distribtn	10	$1.00	29%	No

** Payable annually. Will be reduced in future years for both "A" and "S" share classes in case of "distribution overages." Will be increased in future years for "S" share classes to adjust for redemption of shares from the investors' account to pay an assumed external advisory fee of 1% per year. †Balance in bonds/cash. Source: Russell Investments.*

One potential use Russell sees for the funds is as a "bridge" strategy that could allow investors to use the ending wealth from the funds to annuitize at a lower cost, because by the end of the 10- or 20-year terms of the funds they would be at a more advanced age (since the cost of annuitizing generally falls with age). Russell is encouraging advisors using the funds for their clients' portfolios to continuously explore the option to annuitize assets to help ensure continuing lifetime income (so the funds could become a means of postponing the annuitization decision for clients who plan to annuitize at some point).

The asset classes represented by the underlying multi-managed Russell funds may include U.S. and non-U.S. stocks, real estate securities, bonds, and cash. The FoFs **dynamically adjust allocations based on a quantitative model**, run daily, that takes into account time remaining until the end of the FoF's 10- or 20-year term, its current NAV, and future distributions to be made by the fund.

For instance, in a favorable market, the fund may adopt a more aggressive asset allocation stance, and in a less favorable market, it may become more conservative in its investments. However, the prospectus states: *"if investment performance is substantially below assumptions in the investment model such that even a very conservative asset allocation appears unlikely to meet a Fund's primary objective of paying the stated target distribution, the Fund may shift into an asset allocation with higher risk and higher potential for return to increase the likelihood that the Fund can make its target distributions."*

John Hancock's Retirement Distribution Funds

John Hancock's *Retirement Distribution* and ***Retirement Rising Distribution* funds** went live this January, but only have corporate seed money in them yet, with active marketing and promotion expected to begin towards the end of the year. The funds are structured similarly to the "*Lifecycle Retirement Portfolio*" started in 2006 as part of the manager's target-date series—that portfolio aims for (but does not guarantee) a rate of return that will support an inflation-adjusted annual withdrawal rate of 6% of initial investment over the long-term (roughly 30 years), while trying to minimize downside risk in any 12-month time period. The Retirement Portfolio has a strategic allocation of 50% to equity funds and 50% to fixed income funds, with some tactical management in response to market conditions. The equity fund portion includes allocations to commodities, natural resources, TIPs and global real estate, and options and futures may be used as well to hedge equity risk. The newer ***Retirement Distribution*** fund, however, goes one step further and seeks to actually pay out a dollar amount of $0.60 per share annually; in four equal quarterly distributions (the fund also seeks "modest capital appreciation"). Its companion ***Retirement Rising Distribution*** fund targets an initial $0.40 annual distribution amount per share (also paid in equal quarterly installments), and seeks to increase that annual payout by the rate of inflation as measured by the average annual change in the CPI over the prior three years. The prospectus mentions that payout rates may be increased or decreased in the future for reasons such as changes in market performance or reinvestment of "excess distributions."

Both the ***Retirement Distribution*** and ***Retirement Rising Distribution*** funds are **perpetual** offerings that have a secondary objective of capital appreciation. Their "neutral" allocations are 60% fixed income funds and 40% equity funds. Asset allocation modeling is done by sub-advisor **MFC Global (USA)**, a Canada-based affiliate. The funds anticipate generally allocating 90% of assets to sub-advised John Hancock funds, with the remainder of assets invested directly in securities or ETFs.

Selected Retirement Income / Managed Payout Funds

Portfolio Name	Start	Assets $MM 6/08	Net Flows $MM '07	1H08	Jun08	Net Exp. Ratio%
Vanguard						
MP - Gro & Dist Focus	4/08	**128.5**	-	133.2	24.2	0.57
MP - Distbn Focus	4/08	**94.8**	-	97.9	21.4	0.58
MP - Growth Focus	4/08	**53.9**	-	56.7	4.8	0.58
Subtotal Vanguard		***277.2***	***0.0***	***287.8***	***50.4***	
Schwab						
Mthly Inc- Max Payout	3/08	**34.3**	0.0	33.8	-1.8	0.61
Mthly Inc- Enhn Pyout	3/08	**13.6**	0.0	13.5	-1.6	0.68
Mthly Inc- Mod Payout	3/08	**10.0**	0.0	10.0	0.1	0.76
Subtotal Schwab		***57.8***	***0.0***	***57.4***	***-3.3***	
Fidelity						
Inc Replcment 2016	8/07	**9.3**	4.8	4.7	0.3	0.54*
Inc Replcment 2028	8/07	**7.1**	2.8	4.6	1.0	0.61*
Inc Replcment 2018	8/07	**6.9**	3.3	3.7	0.7	0.56*
Inc Replcment 2022	8/07	**5.3**	2.8	2.8	0.3	0.58*
Inc Replcment 2020	8/07	**2.4**	0.7	1.7	0.0	0.57*
Inc Replcment 2036	8/07	**1.7**	1.4	0.4	0.1	0.65*
Inc Replcment 2038	12/07	**1.5**	0.5	1.1	0.2	0.66*
Inc Replcment 2032	8/07	**1.5**	1.2	0.3	0.1	0.63*
Inc Replcment 2024	8/07	**1.5**	0.9	0.7	0.1	0.59*
Inc Replcment 2026	8/07	**1.4**	1.1	0.4	0.0	0.60*
Inc Replcment 2042	12/07	**1.3**	0.5	0.9	0.0	0.67*
Inc Replcment 2030	8/07	**1.1**	0.7	0.5	0.0	0.62*
Inc Replcment 2040	12/07	**1.0**	0.5	0.6	0.1	0.66*
Inc Replcment 2034	8/07	**1.0**	0.8	0.3	0.0	0.64*
Subtotal Fidelity		***42.9***	***21.9***	***22.7***	***2.8***	
DWS LifeCmpss Inc	12/07	**32.8**	**25.0**	**10.6**	**1.1**	1.87*
John Hancock						
Retiremnt Rising Distb	1/08	**4.8**	-	5.0	0.0	1.25†
Retiremnt Distribution	1/08	**4.7**	-	4.9	0.0	1.25†
Subtotal John Hancock		***9.5***	***0.0***	***9.9***	***0.0***	
Russell Investments						
2027 Extended Distbn	1/08	**1.4**	-	1.4	0.8	0.99*
2017 Acceleratd Distb	1/08	**1.2**	-	1.3	0.2	0.95*
2017 Retirement Distb	1/08	**0.8**	-	0.8	0.4	1.16*
Subtotal Russell Invst		***3.4***	***0.0***	***3.5***	***1.3***	
Total Above		**423.6**	**46.9**	**391.9**	**52.4**	

* Direct-sold class. †"A" share. ** "S" share. *Source: SI Simfund*

Newest Entrants: ING and Baron

ING's Global Target Payment fund started at the end of June adds a new twist by incorporating **covered call**

writing in its investment strategy. (Covered call writing was featured in the strategies of several high-distribution equity closed-end funds launched in recent years). The fund plans to combine a global, diversified portfolio of equity and fixed income ING funds, with a covered index call options strategy, in order to try to enhance distributions and reduce volatility. The fund will normally allocate roughly 70% of assets to equity funds and 30% to fixed income funds. Besides trying to make regular (non-guaranteed) monthly payouts, the fund will seek "to preserve investors' capital over the long term", and secondarily, "long-term capital appreciation." The fund's annual payout rate will be set each January, within a range of 5% to 7% (it has been set at 6% for 2008). The payout rate would be applied to the average month-end NAV over the previous three calendar years (or if shorter, since inception). The fund's "A" shares carry a net expense ratio of 1.30%.

Also launched at the end of June was **Baron Capital Management's Retirement Income** fund, an **equity** offering that focuses on small to mid-sized growth securities in the US, picked for their capital appreciation potential. The fund, which carries a net expense ratio of 1.35%, has the flexibility to sell securities short and make private equity investments (it may not invest more than 15% of assets in restricted or illiquid securities though). It will try to make an annual distribution equal to a minimum of 4% of the fund's NAV measured as of the prior year-end. Distributions will be reinvested unless the fund is directed otherwise. Like the Vanguard MP funds, Baron's fund refers to its similarity to college/university endowment funds, with its prospectus stating:

"…The goal is similar to that of college endowments, which are managed to provide both current income and principal growth. Such endowments typically spend 4% of the endowment's beginning net assets for annual operating expenses. This strategy has typically allowed both the endowment's principal and the amount it is able to distribute for operating expenses to increase over the long term…..."

The Baron Retirement Income fund's managers hope that its long-term investments will permit the fund to double its NAV every five years when the distribution is reinvested or every eight years when it is taken in cash. According to the firm, the same basic investment style was implemented (without a distribution policy) within a predecessor hedge fund, Baron Investment Partners L.P., from 1996 until June 30th 2008, when the partnership was converted into the new Retirement Income mutual fund. Ron Baron, who will run the mutual fund (he also managed the predecessor fund), and his immediate family, owned about half the initial $72 million in AUM.

DWS LifeCompass Income

Started at the end of last year, **DWS Investment's LifeCompass Income fund**, adopts a different approach compared to other offerings so far in this space, as it offers regular, "**protected**" distributions of a fixed dollar amount. It seeks to pay out a fixed-dollar amount equal to 8.25% of the fund's initial NAV (or $0.825) per year, paid semiannually.

The fund has a secondary objective of capital appreciation over its 10-year term. Although it will attempt to achieve an NAV on maturity date that's at least equal to its initial NAV, it only assures shareholders the return of 17.5% of principal. Helping back its assurance to investors as to the "protected" amounts (both distributions and return of 17.5% of principal at maturity), is the fund's **financial warranty agreement with Merrill Lynch Bank USA** (currently capped at $1 billion). Using a quantitative "Constant Proportion Portfolio Insurance" (CPPI) strategy, the fund rebalances daily between an "**active equity component"** that seeks capital appreciation and a **"reserve component"** that aims for protection. The **active equity piece** is designed to provide exposure to global equity markets through investments in futures contracts on, and ETFs, that track large-cap, mid-cap and small-cap, and international stock market indices, while the **"reserve" component**, will generally be chiefly invested in zero-coupon bonds, although it can also invest in the DWS Short Duration Plus fund. The lower the yield on the underlying bonds, the higher the share of the reserve component in the initial mix, and as interest rates decline, the CPPI strategy will allocate more assets to the reserve component. Also, in general, as equity market volatility increases, the fund may reduce its exposure to the active equity component. As of June 30th, the fund was 73% invested in the reserve component. The fund's "A" share net expense ratio of 1.87% includes a **financial warranty fee of 0.585%**.

Future Evolution

John Hancock has reportedly sought exemptive relief from the SEC to allow it to offer funds with a guarantee from an *affiliated* provider—if granted, this could start a new class of products in this new space.

Along with refining of investment strategies and distribution rules, one future path along which open-end managed payout funds could possibly evolve is to offer multiple risk models, with each risk model offering a choice of distribution rates, allowing investors to pick the risk profile and payout rate their life circumstances call for (similar to the development of accumulation-focused target-date series with multiple risk-specific glidepaths.)

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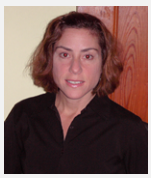

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Share Class Trends: Ws, Ps, Fs

In recent years, the addition of new Institutional and Retirement share classes was common as funds were fine-tuning pricing structures to add to the already available "As," "Bs," and "Cs". Lately, we are noticing some other new types of share classes, some that focus on lower-fee options for fund wraps and UMA accounts. But unlike A/B/C share classes, the new generation of classes shows great inconsistencies, as suggested below. **If reform of 12b-1 fees materializes, significant share class fine-tuning would be triggered and SI looks forward to working closely with SimfundFiling.com subscribers during such a restructuring phase.**

W Shares

The W share's story begins in March of 2004, with **Royce's** registration of W shares for the **Royce Premier Shares** and **Royce Total Return** funds (Royce's "Ws" featured a minimum initial investment of $1 million). However, it was not until 2006, with **MFS's** registration of its W shares (dedicated for the "wrap" business; using a modest 12b-1 fee; the first fund to file it was MFS Value in February, followed by seven more funds in April that year) that the new share class actually captured the industry's eye. Later the same year, **Wilmington** and **RiverSource** filed wrap shares, followed in 2007 by registrations from **Morgan Stanley**, **Citigroup**, **MFS**, and **ING**. In 2008, **MFS** and **Morgan Stanley** registered W shares for the **MFS High Yield Opportunities** and **Morgan Stanley Commodities Alpha** funds, and **ING** registered W Common shares to the continuously offered closed-end **ING Senior Income** fund this past April.

W Shares Fees and Expenses: W shares are all no-load, but they differ in other respects from manager to manager. Minimum initial investments fluctuate from the absence of a minimum (**Citigroup** and **MFS**) to requiring a minimum investment of $1 million (**Royce**). Finally, 12b-1 fees will not be charged by **Royce**, **ING**, and **Citigroup**, with **MFS** charging 0.10%, **Wilmington** 0.15%, **RiverSource** 0.25%, and **Morgan Stanley** topping the list at 0.35%.

F, F1, and F2 Shares

F shares (including F1 and F2 shares) have joined W shares as a growing class. The shares are offered to wrap accounts, as well as open to most qualified registered investment advisors, broker-dealer firms, and financial institutions that have specific agreements with fund management. **Legg Mason** takes it one step further, *ceasing sales of Class A and B shares to new plan investors through a service agent when Class FI shares are available*. **Summit** registered the first F shares in 2002, followed by **Artio Global Management** (formerly **Julius Baer**) in 2003, **Federated** in 2005, and **Columbia**, **Reich & Tang**, and **Prudential** in 2006. However, it was **American Funds**, **Legg Mason**, and **Lord Abbett** that brought real attention to F shares when these managers recently included the new share class.

F Shares Fees and Minimums: Except those of Federated and the American Funds, "F" shares charge 12b-1 fees (which range from Lord Abbett's 0.10% to Columbia's atypical 1.00%). **Minimum initial investments**, where they exist or are specified, range from $1,000 to $5,000 for "F" shares.

P Shares

In 2005, **Schwab** offered P shares to charitable giving funds and tax-advantaged retirement plans, and that same year, **Lord Abbett** filed P shares dedicated to the retirement market. **PIMCO/Allianz Global Investors** "Ps" (wrap-focused, not for the small DC plan market) followed in 2008 (to service agents with arrangements—certain asset allocation, wrap fee, and other similar programs offered by broker-dealers and other financial intermediaries).

P Share Fees and Minimums: "P" shares carry 12b-1 fees (ranging from the 0.10% charged by PIMCO /Allianz's "Ps," which are targeted at UMAs and wraps, to the 0.45% for the Lord Abbett "Ps," which are targeted at small DC plans). Minimum initial investments varied greatly from Lord Abbett's $500 to PIMCO /Allianz's $5 million.

Value-Added Programs: Evolving Wholesaler Roles

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Against the backdrop of market turbulence in recent months that has underscored the value of financial advisors, we looked at changes in "Value-Added Programs," those seminars, whitepapers, and other content that wholesalers provide to financial advisors that are not directly related to product information. **Value-Added Programs have evolved over the past few years, with more emphasis on Web-based delivery methods and more focused portfolios of programs**. (For more on this, see SI's just-published, detailed study, "Evolution of Value-Added Programs Delivered via Wholesalers," available online here.)

Even with changes, the goal has remained the same: to have the financial advisor (FA) see the fund management company and its wholesalers as partners who can act in a consultative relationship, helping the advisor build his/her business and explain strategies to clients. Thus, **the relationship of the wholesaler to the FA increasingly echoes the 'partnership' relationship of the FA to the investor.**

Increased importance

For most firms, Value-Added Programs have taken on increased importance. In a world where many firms offer not-dissimilar equity, bond and target-date funds, **Value Added Programs can help fund firms differentiate themselves to advisors.**

Many fund management firms have increased their use of Value-Added Programs in general over the past 3-to-5 years. Large firms especially can be opportunistic about these programs, responding to changing markets.

At the same time, some firms have tactically narrowed the number of programs they offer based on a more realistic view of the range of programs they can effectively maintain, and the kinds of programs that truly support their product line and/or brand.

Either way, fund management firms are:

- Targeting different content at different distribution channels (e.g., market commentary for some RIAs, but referrals tactics for some Wirehouses' FAs)
- Positioning themselves as a 'thought leader' in a limited number of areas that pay off
- Using CRM software/Website to track FA usage of programs and subsequent sales.

Firms continue to search for effective ways to ensure that resources spent on Value-Added Programs result in more sales, but sharper approaches are evident.

Leveraging the Web

Technology is enabling new, faster ways of delivering content to advisors. Yet, as one sales executive put it: *"Nothing will ever replace the face-to-face meeting."* **Firms agree that in-person meetings are the most effective form of Value-Added content delivery.** Brochures brought by the wholesaler in person or Web pages pointed out by the wholesaler on a visit are much more likely to have an impact on the FA. Even when an article or presentation has been downloaded from the fund sponsor's Website, the efficacy of the material for the FA may increase if the sponsor's wholesaler follows up and discusses the material.

Meanwhile, more fund sponsors are finding they can easily and inexpensively put materials such as articles, research and brochures, or Webcasts, on the Web for advisors to download. Longstanding concerns that FAs aren't tech-savvy enough to use online content are starting to fade. SI interviewed several FAs of varying ages who said they'd like market commentary conference calls and similar content available as podcasts to be accessed on demand.

So, firms attempt to make content available in multiple formats to serve all constituencies. For example, one firm makes its quarterly market-commentary conference call available live, as a replay, as a podcast, and in transcript form. Naturally, the Web will play an expanding role in Value-Added Programs in the future. **In particular, Webcasts and podcasts are seen as growth areas going forward.**

Fund distribution seems to be evolving into a model where the wholesaler remains the focal point in one-on-one meetings, but also serves as the guide to the rich Value-Added content available on the fund company's Web site. Going forward, this best-of-both-worlds approach will become even more common.

Closed-End Funds: Grappling with Credit Challenges

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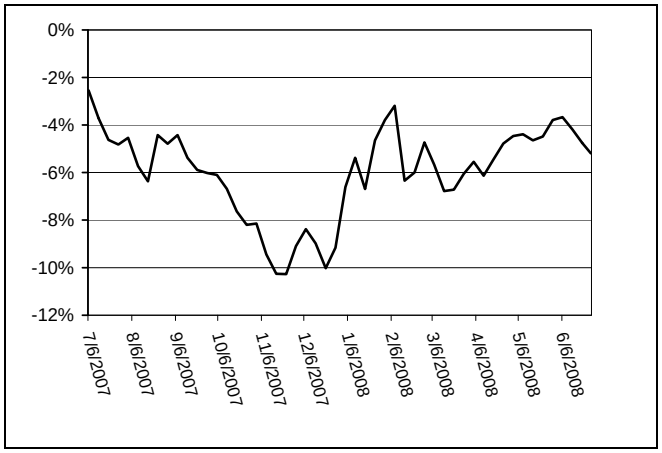
The credit crunch of 2007-08 hurt closed-end funds (CEFs) and a freeze in the market for Auction-Rate Preferred Securities (ARPS) has cast another cloud over CEFs for months. Market turmoil, losses among recently offered CEFs, and market-price discounts to NAV (around 5% on average), are a few of the reasons that have shut down IPOs. Strategic Insight tracked $294 billion in CEF assets at the end of May, down slightly from $307 billion at the end of last year.

CEF Discounts to NAV June '07-June'08



Source: FundData.com

According to Bank of America, CEFs had issued some $63 billion of ARPS to add leverage (with the aim of boosting yield). But starting on Feb. 13, 2008, the broker-dealers who run the "Dutch" auctions of ARPS and often bid on ARPS themselves pulled back from buying. Auction failure rates soared above 70%. The 24-year-old ARPS market froze, and many ARPS holders, including retail investors, have been unable to redeem their ARPS, as the regular auctions were these securities' only liquidity events. CEFs have maintained much of their ARPS leverage, but the market for new ARPS is essentially non-existent.

As CEF sponsor firms have a fiduciary responsibility to both ARPS and CEF shareholders, the ARPS freeze created a new complexity. Some managers have been redeeming portions of their outstanding ARPS and replacing them with bank loans and other alternatives, but less than one-third of CEFs' total ARPS have been redeemed so far.

ARPS have been an effective leverage instrument because as preferred stock, they are permanent capital, yet because their interest rates are reset at auctions every seven, 28 or 35 days, they pay coupons at short-term rates. Going forward, **CEFs are searching for new vehicles for leverage.** The catch: leverage can be as much as 50% of a CEF's total assets if it is in equity form (such as ARPS), but no more than 33% of total assets if it is in debt form. CEFs would thus prefer an equity form of leverage to be able to maintain the same leverage ratios.

The SEC and IRS issued no-action letters in June to **Eaton Vance**, the third-largest manager of CEF assets, allowing it to try to create new securities called Liquidity Protected Preferreds (LPPs) to replace ARPS. LPPs would be preferred securities with coupons that reset weekly, but would also contain "put" options allowing holders to sell them to liquidity providers outside of auctions. The "put" would in theory make money-market funds eligible to buy them (unlike ARPS). The SEC's assent should also clear a path for similar preferred securities with put options being developed by the biggest CEF manager, **Nuveen**, and the number three CEF manager, **BlackRock.** The key advantage to these securities is that they count as equity, so funds could use them to replace ARPS and maintain the same leverage ratio.

We may see the first issue of LPPs within a couple of months, and four Nuveen CEFs plan a roughly $500 million offering of similar preferred securities with put options in August. But it will take time to find more firms to act as liquidity providers (by buying the securities when puts are exercised) at prices that don't hurt CEF shareholders, and gradually build up a market for the new securities. Refinancing of ARPS could drag on into 2009. But if LPPs and similar preferred securities do catch on with money-market funds, they could prove in the long run to be better, more liquid leverage vehicles than ARPS ever were.

Meanwhile, industry participants believe that marked progress on ARPS refinancing could boost confidence in CEFs and may lead to a few IPOs by the end of the year—if the stock market cooperates.

Money Management Profitability

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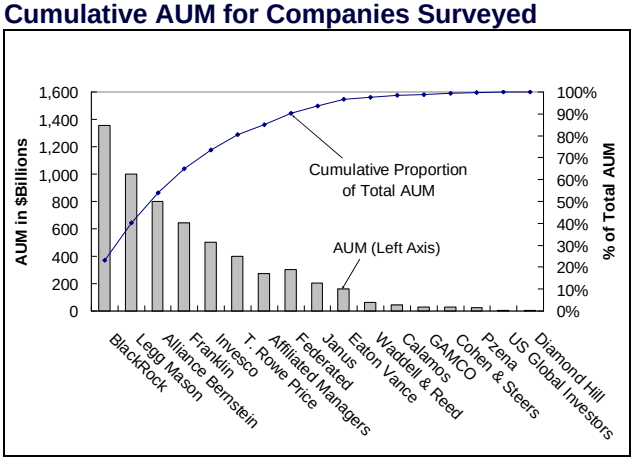
The 2007 Financial Results of Publicly Held Money Managers

The 17 money managers with publicly-held equity surveyed this year by SI *("Public Companies")* for their financial results managed nearly $6 trillion (including close to $2 trillion in mutual fund assets) at the end of 2007.

A couple of changes to the universe for SI's benchmarking study of 2007 results posted on Sionline.com: Nuveen was excluded as it was taken private by a group of investors led by Madison Dearborn in late 2007. Pzena Investment Management, a value-oriented firm (and sub-advisor to several John Hancock funds), which went public last year, was added.

Sixteen of the 17 total companies we surveyed each increased AUM during 2007, which resulted in an overall annual asset increase of 16% for the Public Companies. The Public Companies collectively garnered over $35 billion in revenues and generated roughly $7.2 billion in profits.

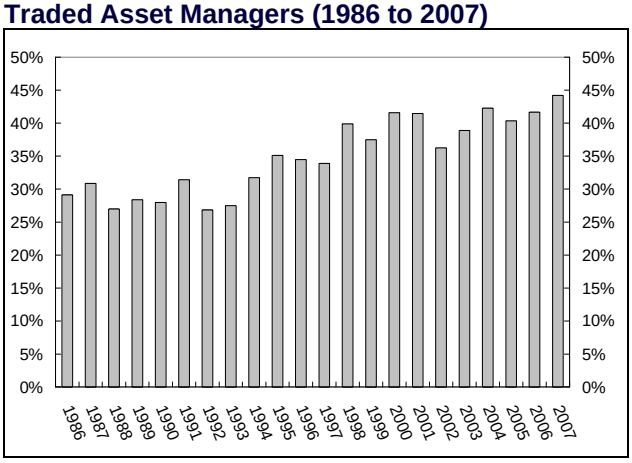
Cumulative AUM for Companies Surveyed



Source: Company Reports, Strategic Insight

The average money management pre-tax operating margin for the group was 44% during 2007 (as calculated by SI)**, up three percentage points from that in 2006 (41%). The median pre-tax operating margin for the group was also 44%, the highest recorded in the 20+ year history of the SI study.**

Median Pre-Tax Operating Margins for Publicly Traded Asset Managers (1986 to 2007)



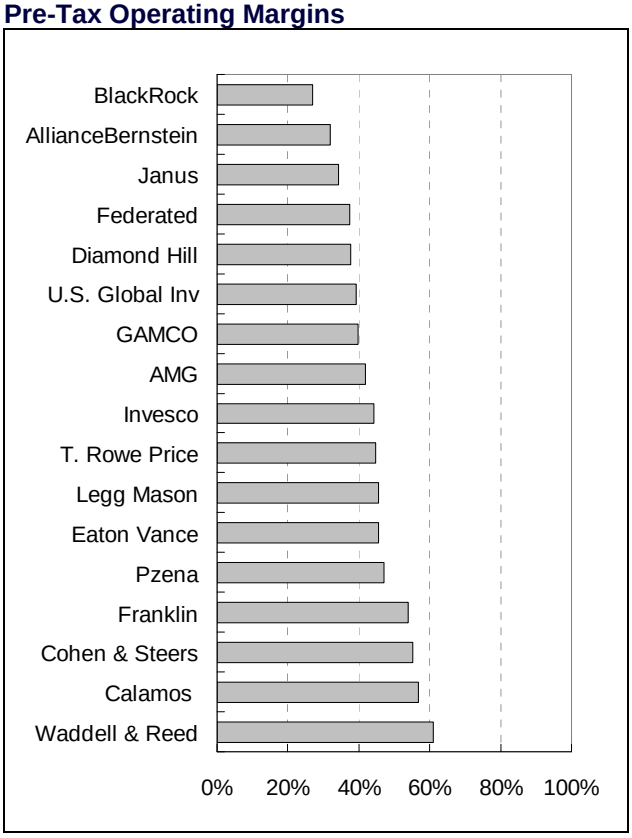
Results for each year include the historical data of Public Managers during that year, based on SI's past surveys; Sources: Company reports, Strategic Insight

Operating margins among the Public Managers ranged from 27% to 61% (see chart on following page).

Demonstrating the leverage typically available to money managers was the rise in pre-tax operating margins for 14 of the 17 companies surveyed. Five of these 14 firms managed to each improve margins by 5% or more. Aside from Calamos's margin decrease of 7% (attributable to non-recurring charges), no company in our 2007 survey experienced a more than 2% decline in its operating margin as compared to 2006.

While profitability in 2007 was remarkable, the challenging environment in 2008 may result in investment managers using to a greater extent their flexibility in adjusting cost structures, similar to that exercised in previous down-cycles, when expenses were managed in parallel with revenue trends.

Pre-Tax Operating Margins



Source: Company Reports, Strategic Insight

Public Managers' 2007 Revenues

The aggregate operating revenues of the Public Managers rose 28% from 2006 levels.

All but one company experienced revenue growth. BlackRock continued to enjoy dynamic growth in fee revenues (a 137% increase compared to 2006), which is attributable to several factors, including the company's acquisition of Merrill Lynch Investment Management and of the FoF business of the Quellos Group; plus the expansion of BlackRock solutions, a risk management/investment subsidiary.

Public Managers' Composite Annual Revenue Growth Rates

	2003	2004	2005	2006	2007
Operating Revenues	11%	20%	21%	28%	28%

Source: Company reports, Strategic Insight

… And Their Expense Trends

Most of the Public Companies witnessed increases in operating costs along with AUM expansion. Only one company (Pzena) managed to lower its expenses as compared to 2006. Fourteen out of the 17 Public Companies were able, however, to keep fee revenue increases above or equal to corresponding rising costs.

Public Managers' Composite Annual Expense Growth Rates

	2003	2004	2005	2006	2007
Operating Expenses	9%	14%	19%	25%	25%

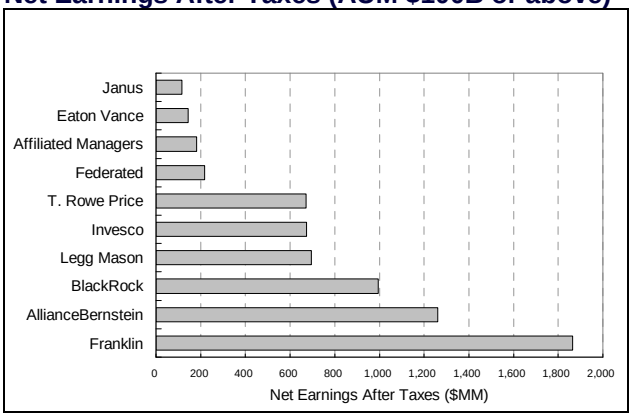
Source: Company reports, Strategic Insight

Public Managers' 2007 Net Income

Six of the companies surveyed each had net income figures above $600 million, with two of these companies each topping the $1 billion threshold. Only three firms saw declines in Net Income, mostly due to non-recurring charges and one-time restructuring costs.

Larger Asset Managers

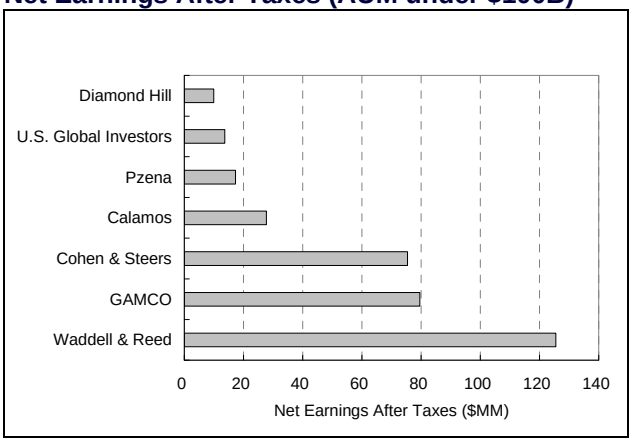
Net Earnings After Taxes (AUM $100B or above)



Source: Company Reports, Strategic Insight

Smaller Asset Managers

Net Earnings After Taxes (AUM under $100B)



Source: Company Reports, Strategic Insight

Fees & Expenses: 2007 Trends

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For over 10 years, Strategic Insight has been sharing commentary and analysis on mutual fund fees and expenses. Our 2007 Fee and Expense Benchmarking studies are available on www.sionline.com.

- The first report, *Mutual Fund Industry Fee and Expense Benchmarks*, presents fee and expense benchmarks for actively managed open-end funds aggregated into 30 categories.
- The second report, *Contractual Management Fee Breakpoint Schedule Comparison*, provides contractual management fee breakpoint schedule statistics for actively managed open-end mutual funds aggregated into 28 categories.

With industry assets rising and cash flows concentrated in lower-fee, high performance funds and management companies, the industry's effective fee ratios (asset-weighted ratios paid by the "average investor") have been inching downwards in recent years.

Average Total Expense Ratio % (Asset-Weighted)
Actively Managed Open-End Funds; Excluding VAs

	2003	2004	2005	2006	2007
US Eqty / Hybrid	1.05	1.01	0.96	0.92	0.90
Int'l Equity	1.23	1.17	1.11	1.07	1.03
Taxable Bond	0.80	0.78	0.75	0.72	0.70
Tax-Free Bond	0.68	0.67	0.66	0.65	0.63
Taxable MMFs	0.45	0.43	0.43	0.43	0.41
Tax-Free MMFs	0.47	0.45	0.42	0.41	0.39

Source: Strategic Insight Simfund, SI Research

The table above weights the total expense ratio by the average size of each fund during the particular year, to capture **the experience of the average investor** (and thus reduce the statistical influence of many small funds that are more expensive but held by just a few).

To help in "apples-to-apples" comparison, **the table also excludes passively managed low fee funds**. Closed-end and VA funds, both of which have somewhat different expense structures, are also excluded.

To exclude the impact of 12b-1 fees (as we have discussed in numerous studies, competitive marketplace trends are reducing the industry's use of 12b-1 fees), the following table shows **trends in fund fees excluding 12b-1 fees.**

Average Total Expense Ratio %, Exc. 12b-1 Fees (Asset-Weighted)
Actively Managed Open-End Funds; Excluding VAs

	2003	2004	2005	2006	2007
US Equity / Hybrid	0.82	0.78	0.74	0.72	0.70
Int'l Equity	0.99	0.94	0.89	0.86	0.82
Taxable Bond	0.58	0.57	0.56	0.54	0.54
Tax-Free Bond	0.51	0.50	0.49	0.48	0.46
Taxable MMFs	0.34	0.34	0.33	0.32	0.31
Tax-Free MMFs	0.39	0.37	0.35	0.33	0.31

Source: Strategic Insight Simfund, SI Research

The steady declines in total expense ratios among Bond and Money Market funds are mostly attributed to equivalent reduction in management fees (plus a small decline in non-management expenses).

Total expense ratios for Domestic and International Equity funds have declined 12 and 17 basis points respectively (excl. 12b-1 fees), **whereas management fees have declined 4 and 5 basis points** (see below). Thus, operating expenses for equity funds have also trended lower in recent years.

Average Advisory/Administrative Fee Ratio % (Asset-Weighted)
Actively Managed Open-End Funds; Excluding VAs

	2003	2004	2005	2006	2007
US Equity / Hybrid	0.590	0.579	0.559	0.551	0.547
Int'l Equity	0.716	0.712	0.684	0.677	0.663
Taxable Bond	0.455	0.432	0.425	0.417	0.419
Tax-Free Bond	0.423	0.415	0.404	0.392	0.385
Taxable MMFs	0.260	0.247	0.237	0.228	0.226
Tax-Free MMFs	0.304	0.285	0.264	0.257	0.246

Source: Strategic Insight Simfund, SI Research

Asset growth, larger average account sizes, and on-going liquidations of smaller funds (2,000 portfolios since 12/02) explain the decline in operational fees.

Variable Annuities



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SI recently published an ***annual update on the variable annuity business, "Variable Annuity Trends: Industry Gearing Up to Meet Retirement Income Needs"****. This study provides a wealth of data about funds underlying VAs, including discussions of flow trends, fee benchmarking, the importance of Guaranteed Living Benefits for VA sales, and VA funds-of-funds. Leveraging SI's AnnuityInsight.com research, the report details innovations among VA underwriters.*

Business Method Patents

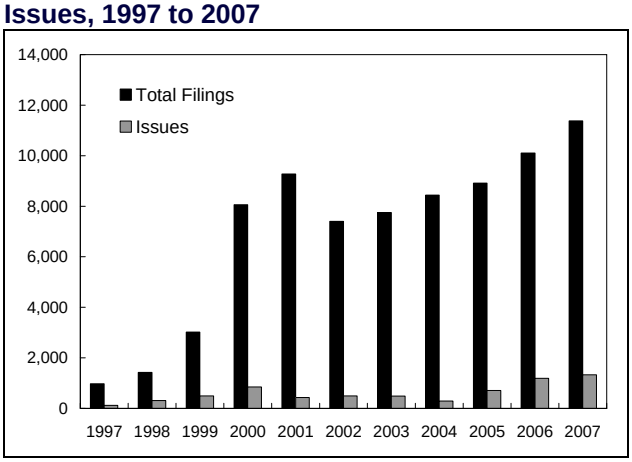
Although some insurance carriers have employed a strategy of patenting the processes associated with variable annuities for years, this area is burgeoning with new questions for carriers, whether they elect to actively pursue a patenting strategy of their own or need to deal with the possibility of patent infringement suits. Furthermore, **the issue of business method patents also is increasingly reaching into other realms of financial services, including mutual funds and other investment products.**

Following the landmark 1998 *State St.* case that validated a patent on hub-and-spoke mutual funds, the floodgates for other business method patents opened, though issued patents remain low (see below).

Let the Courts Decide?

In the VA industry, Lincoln Financial is currently pursuing patent infringement cases against Transamerica and Jackson National Life for patents related to living benefits. Naturally, patents do not end with the U.S. Patent and Trademark Office but instead are ultimately validated in the court system; only upon subsequent litigation is it clear whether a given patent will "stick," and even then after a very long period of time. Several recent cases have reduced the cost of infringement for companies that lose cases, both by making it more difficult for infringers to be found "willful" and by making it more difficult for patent protectors to have permanent injunctions filed against willful infringers. Notably, one pending judicial decision, *In re Bilski*, is examining the validity of business method patents in the first place. Since business method patents are not globally recognized, such as in Europe, it is not clear whether there is a compelling reason for the U.S. to support a different patent system.

Business Method Patents: Applications and Issues, 1997 to 2007



Source: U.S. Patent and Trademark Office, SI

Public Policy Question

Are business method patents for financial services products good for consumers? After all, consumers end up paying the costs of maintaining a stable of patents, fueling an aggressive strategy against infringers (if elected); defending against such cases; or providing cross-licensing opportunities in the case of infringement.

Time on Industry's Side?

It will take many years to resolve the questions surrounding business method patents, yet individual insurers must make a determination about their own strategies. One can also throw into the mix potential methodology changes that the USPTO would like to implement for an additional element of uncertainty. However, as annuity product development races along at top speed, the patent application process and ensuing litigation attenuate in the opposite direction.

We invite you to **read relevant articles posted on AnnutyInsight.com, particularly a recent piece entitled, "Insurance Product Patent Update."**

Simfund MF Tips: Lifecycle Funds

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Lifecycle funds took in an estimated $76 billion in 2007 and an additional $27.5 billion this year through May (excluding VA-underlying funds). The number of lifecycle funds has tripled compared to 2002, with nearly 700 lifecycle funds available currently. In this edition of Windows, we'll explore **some ways of querying for lifecycle funds in Simfund MF**.

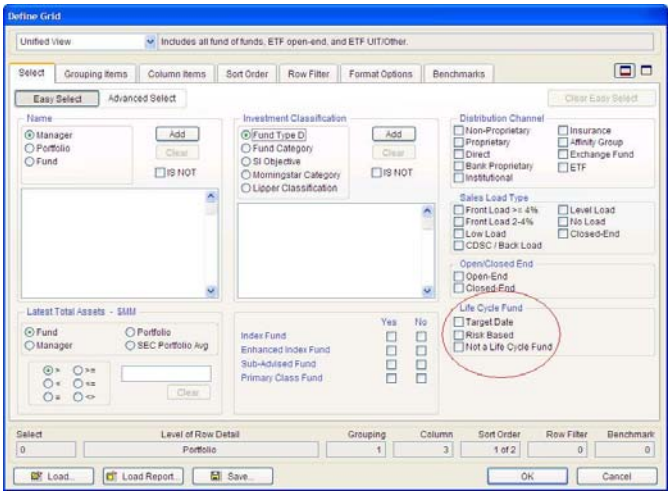
Lifecycle Funds: Purpose and Simfund Methodology

Lifecycle funds are asset allocation funds designed to offer a "packaged" solution that leaves the asset allocation decision and rebalancing to others. Lifecycle mutual funds today are typically structured as affiliated or unaffiliated funds-of-fund (FoFs), although some lifecycle series are composed of funds that invest directly in securities. In Simfund, we categorize lifecycle fund series into two broad categories: **Target-Date** and **Risk-Based.**

Target-date lifecycle funds are offered with a "target" retirement year in mind, such as 2025, 2030, or 2040, etc., and are structured to automatically become more conservative over time as that target-date approaches. **Risk-based lifecycle funds** are targeted to particular risk profiles (typical permutations being conservative, moderate, and aggressive) and have a largely static asset allocation, the onus being on investors to determine their risk tolerance and time horizon, and then shift from one fund to another in the series at the appropriate time as their risk tolerance/horizon changes.

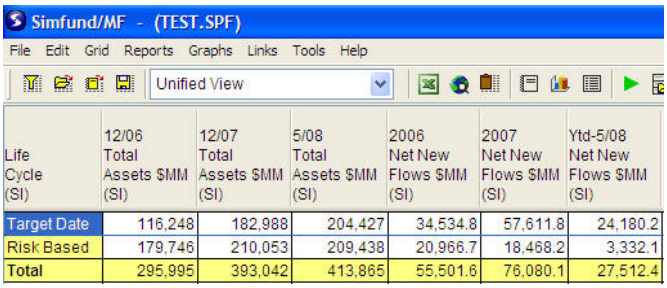
Standard View vs. Unified View

One way in which to query for lifecycle funds in Simfund MF is in the "Unified View". This view enables you to quickly and conveniently see all lifecycle funds, whether FoF or standalone in the same view. *[For non-lifecycle fund-related queries in the "Unified" view, please note that in its default setting, the view also captures 529 plan funds.]* Why not just use the "Fund of Funds View"? Because, there is a small portion of the lifecycle fund universe that comprises of funds that invest directly in securities rather than in mutual funds, and the Fund-of-Fund view would exclude such stand-alone lifecycle funds. Once in the "Unified View", you can pick Lifecycle Funds in the "Easy Select Screen" itself.



To get the output in the screen shot below would require selecting both target-date and risk-based lifecycle funds, picking "Life Cycle Fund" as the "Grouping Item", and picking the particular "Column Items" shown.

Assets and Flows by Lifecycle Fund Type



Life Cycle (SI)	12/06 Total Assets $MM (SI)	12/07 Total Assets $MM (SI)	5/08 Total Assets $MM (SI)	2006 Net New Flows $MM (SI)	2007 Net New Flows $MM (SI)	Ytd-5/08 Net New Flows $MM (SI)
Target Date	116,248	182,988	204,427	34,534.8	57,611.8	24,180.2
Risk Based	179,746	210,053	209,438	20,966.7	18,468.2	3,332.1
Total	295,995	393,042	413,865	55,501.6	76,080.1	27,512.4

- **Tip: Toggle between Views**

After having selecting lifecycle funds in the Unified View, there is a quick way to get to the subset of lifecycle funds structured as standalone funds. Simply change your view from "Unified View" to the "Standard View" (the "Standard View" excludes funds-of-funds).

Highest YTD Flow Lifecycle Fund Managers

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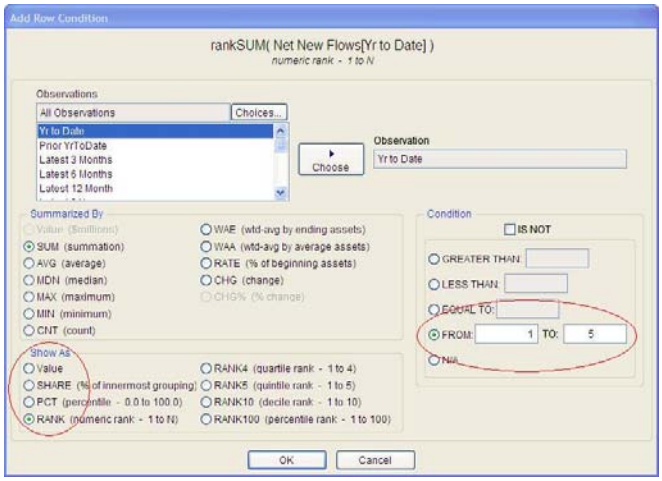
Unified View

Manager Name (SI)	5/08 Total Assets $MM (SI)	2006 Net New Flows $MM (SI)	2007 Net New Flows $MM (SI)	Ytd-5/08 Net New Flows $MM (SI)	5/08 Portfolio Count (SI)
Life Cycle Fund (SI) "Target Date"					
Fidelity	93,610	14,984.7	19,155.3	**6,987.9**	37
Vanguard	38,275	6,691.7	14,016.9	**6,638.9**	11
T Rowe Price	34,252	7,271.4	11,528.2	**4,527.3**	12
Principal Funds	12,880	2,534.1	4,039.9	**2,018.4**	11
American Funds	2,884		1,569.9	**1,309.3**	9
Life Cycle Fund (SI) "Risk Based"					
John Hancock	28,476	3,998.5	3,624.2	**1,166.7**	5
OppenheimerFunds	5,044	1,771.0	1,553.6	**638.7**	5
Transamerica AM	9,363	1,526.3	1,178.7	**424.2**	4
Thrivent Financial	2,812	1,003.8	937.1	**354.8**	4
RiverSource	3,917	690.3	368.4	**261.5**	6
Total	231,518	40,472.2	57,972.7	**24,328.1**	104

In the screen shot above, we show the five managers within each lifecycle fund type that had the highest net inflows year-to-date.

- **Tip: Row Filter**

The "Row Filter" tab in the "Define Grid" mode allows you to add an additional screen that can help filter your output. To show the five highest YTD flow managers in each lifecycle type, you would need to have "Life Cycle Fund" and "Manager Name" as your first and second "Grouping Items" respectively, and then add a "Row Filter" condition on "Net New Flows [Yr to Date]." In the "Add Row Condition" screen, change the "Show As" section from "Value" to "Rank (Numeric Rank 1 to N)", and set the "Condition" as "From 1 to 5".



Mixed-Asset Target 2020 Funds

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Unified View

Portfolio Name (SI)	Manager Name (SI)	5/08 Total Assets $MM (SI)	Ytd-5/08 Net New Flows $MM (SI)	1 Yr-5/08 Annualized Total Return%-P (LI)	3 Yr-5/08 Annualized Total Return%-P (LI)
Vanguard Target Retiremnt 2020	Vanguard	3,573	**1,052.6**	-1.24	
Price Retirement 2020	T Rowe Price	7,962	**1,045.2**	-3.22	9.21
Fidelity Freedom 2020	Fidelity	21,711	**851.5**	-1.49	8.73
PIF Principal Lifetime 2020	Principal Funds	4,121	**625.3**	-3.57	7.98
American Target Retire 2020	American Funds	572	**259.3**	-0.83	
Fidelity Adv Freedom 2020	Fidelity	1,699	**196.5**	-2.51	8.17
JHF II Lifecycle 2020	John Hancock	247	**112.1**	-2.99	
Wells Fgo Avtg DJ Trgt 2020	Wells Fargo	869	**98.1**	0.92	7.59
AB Retirement 2020	AllianceBernstein	341	**78.5**	-5.92	
TIAA-CREF Lifecycle 2020	TIAA-CREF	270	**60.2**	-2.39	6.73
Barclays Glbl LifePath 2020	Barclays Global	997	**47.9**	-2.40	7.54
JPMorgan SmartRetirement 2020	JPMorgan Funds	283	**47.8**	-4.15	
State Farm LifePath 2020	State Farm	868	**32.1**	-2.82	7.10
Schwab Target 2020	Schwab	222	**18.1**	-6.94	
Russell LifePoint 2020	Russell Invst Grp	109	**15.2**	-0.82	7.77
Vantagepoint Milestone 2020	Vantagepoint	125	**14.7**	-0.56	8.47
Hartford Target Retire 2020	The Hartford	35	**13.6**	0.54	
SunAmerica 2020 Hi Watermark	SunAmerica	77	**13.3**	-5.72	3.99
MFS Lifetime 2020	MFS	83	**13.0**	-0.12	
Oppenheimer Transition 2020	OppenheimerFunds	26	**12.1**	-2.58	
Nationwide Destination 2020	Nationwide Funds	13	**11.0**		
DWS LifeCompass Income	DWS Scudder	33	**9.5**		
TDAX Independence 2020 ETF	XShares Advisors	43	**9.2**		
MainStay Retirement 2020	MainStay Funds	14	**8.2**		
DWS LifeCompass Protect	DWS Scudder	30	**7.2**		
PIMCO RealRetirement 2020	PIMCO/Allianz Glbl	3	**3.2**		
MassMutual Sel DestinRet 2020	MassMutual Finl	660	**2.4**	-3.35	5.19
GS Retirement Strategy 2020	Goldman Sachs	12	**2.4**		
AIM Independence 2020	Invesco Aim Advs	7	**2.2**	-4.54	
BlackRock Prepared 2020	BlackRock	5	**1.7**	1.93	
NestEgg Dow Jones 2020	Amer Indep Finl	35	**1.3**	-0.68	5.89
Payden/Wilshire Longevty 2020+	Payden & Rygel	2	**0.5**		
Banc of America Retire 2020	Columbia Funds	1	**0.3**	-2.52	
RVS Retirement Plus 2020	RiverSource	32	**-5.4**	-7.39	
DWS LifeCompass 2020	DWS Scudder	288	**-8.0**	-3.76	7.52
Putnam RetirementReady 2020	Putnam	97	**-28.3**	-6.38	5.99
Total		45,479	**4,625.7**		

The screenshot above shows funds in the Lipper Classification "Mixed-Asset Target 2020 Funds". [Note: In May 2008, Lipper expanded its Lipper Classifications for target date funds to a total of nine (from 2010 to 2050+, at five-year intervals)].

- **Tip: Portfolio Level Returns**

There are many data points that are only calculated at the "Fund" level or the share class level, such as Total Returns and Total Fees. This causes a problem when you want to look at data at the "Portfolio" level, which rolls up all share classes. SI has alleviated this issue by assigning a "Primary Class Fund" classification to one share class of each fund. In most cases, it is the oldest share class (usually "A" or no-load share class).

Asset Allocations

The screenshot below captures Morningstar asset allocation data as of 5/08 for Lipper's "Mixed-Asset Target 2020 Funds" classification.

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Unified View

Portfolio Name (SI)	Asset Allocation % US Stock (MS)	Asset Allocation % Non-US Stock (MS)	Asset Allocation % US Bond (MS)	Asset Allocation % Non-US Bond (MS)	Asset Allocation % Preferred (MS)	Asset Allocation % Other (MS)	Asset Allocation % Cash (MS)
AB Retirement 2020	49.56	30.45	14.70	1.42	0.04	0.28	3.55
AIM Independence 2020	39.14	16.41	27.91	6.31	1.80	0.01	8.42
American Target Retire 2020	46.18	26.96	16.36	0.65	0.20	0.31	9.32
Banc of America Retire 2020	52.78	16.22	17.78	3.11	0.02	0.20	9.89
Barclays Glbl LifePath 2020	44.38	18.95	27.19	1.05	0.02	0.82	7.60
BlackRock Prepared 2020	28.69	12.67	30.71	6.81	0.51	0.98	19.62
DWS LifeCompass 2020	53.38	15.08	24.44	1.29	0.04	0.98	4.79
DWS LifeCompass Income							
DWS LifeCompass Protect			29.36				70.64
Fidelity Adv Freedom 2020	49.32	17.08	21.62	0.83	0.28	4.15	6.66
Fidelity Freedom 2020	50.18	15.87	17.18	0.92	0.30	9.40	6.12
GS Retirement Strategy 2020							
Hartford Target Retire 2020	43.36	24.74	23.41	0.96	0.07	1.23	6.22
JHF II Lifecycle 2020	45.59	22.41	14.48	8.04	0.14	3.19	6.03
JPMorgan SmartRetirement 2020	46.88	18.52	27.82	1.99	0.09	0.56	4.15
MFS Lifetime 2020	49.13	19.15	25.66	0.52	0.02	0.57	4.95
MainStay Retirement 2020	49.29	18.16	27.08	2.39	0.07	0.41	2.58
MassMutual Sel DestinRet 2020	54.26	18.23	19.09	0.94	0.03	0.09	7.35
Nationwide Destination 2020	41.13	22.96	28.03	0.67	0.04	0.50	6.52
NestEgg Dow Jones 2020	37.73	17.94	27.98	10.19	0.02	0.22	5.93
Oppenheimer Transition 2020	60.06	22.28	12.29	0.05		0.18	5.14
PIF Principal Lifetime 2020	43.35	19.11	27.25	0.62	3.85	0.47	5.31
PIMCO RealRetirement 2020							
Payden/Wilshire Longevty 2020+	38.10	19.42	32.12	2.15	0.02	0.18	8.00
Price Retirement 2020	56.33	18.46	19.34	1.08	0.21	0.81	3.65
Putnam RetirementReady 2020	39.65	12.49	28.15	3.98	0.04	3.22	12.42
RVS Retirement Plus 2020	63.02	18.36	10.10	1.94	0.15	0.16	6.28
Russell LifePoint 2020	28.40	16.44	36.49	0.82	0.11	2.42	15.31
Schwab Target 2020	46.92	18.24	21.41	2.71	0.20	5.85	4.67
State Farm LifePath 2020	46.98	16.86	27.96	1.04	0.02	0.06	7.08
SunAmerica 2020 Hi Watermark			58.58				41.42
TDAX Independence 2020 ETF	46.38	16.17	32.58	3.53			1.34
TIAA-CREF Lifecycle 2020	47.17	21.55	28.18	0.58	0.21	0.21	2.10
Vanguard Target Retiremnt 2020	55.96	6.26	27.74	0.54	0.01	8.20	1.29
Vantagepoint Milestone 2020	39.80	16.55	24.14	1.33	0.01	0.29	17.87
Wells Fgo Avtg DJ Trgt 2020	39.50	18.44	26.77	9.31	0.03	0.53	5.41
Total							

If you have any questions or need help in setting up some of the Simfund MF queries that we have illustrated here, please contact your designated account manager. You can also reach us at the Simfund MF support hotline: (212)217-6884.

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