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Covering Mutual Funds, SMAs, 401(k)s, 529s & More The Newsweekly of Insight & Strategies

At Deadline

Auto Enroll, Lifecycles Boost 401(k) Participation

By Lee Barney

Employers' efforts in recent years to boost participation in their 401(k) plans appear to be making inroads, according to **Hewitt Associates**' annual report on investor behavior in defined contribution plans.

Automatically enrolling participants in 401(k)s, increasing their contribution levels in tandem with raises, simplifying plan choices, offering lifecycle funds and better targeting communications — have all had a positive impact.

Companies whose 401(k) plan automatically enrolled participants had an average

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ICI President Rallies the Troops

Calls on Industry to Help Solve Retirement Dilemmas

By James M Amend

WASHINGTON — Underscoring the theme of enhancing shareholder value, **Investment Company Institute** President Paul Schott Stevens encouraged the money management industry last week to leverage its innovative past and join efforts to enhance mutual fund disclosure and reinvent the defined contribution space for the next generation of retirees.

"Where serving the interests of mutual fund investors is concerned, we must never stop swinging for the fences."

— Paul Schott Stevens
President, Investment Company Institute

As he recounted how the mutual fund industry has grown from its modest, "Dutch fund" beginnings in 1774 to a manufacturer of products that today meets nearly every investor's needs and desires, Stevens said it is incumbent upon the industry to embrace and shape future disclosure in a way that similarly

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SEC to Host CCO Roundtables
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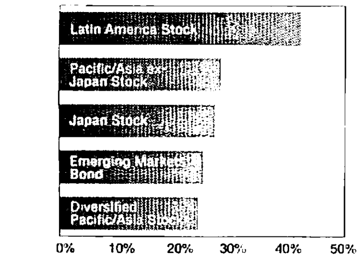
Data Points

Top 5 Trailing 12-Month ROA for Long-Term Funds by Category



Return on Assets (ROA) is the ratio of net sales to assets which, for public companies, offers insight into the return they are able to generate from existing assets. For mutual funds it offers some insight into the most efficient sales categories. In particular, there is evidence that niche categories, such as Latin America and Japan Stock funds, are benefiting from a much larger increase in the popularity of international funds where sales were $158.5B over the past 12 months.

Source: Financial Research Corp.

Tax Cuts Will Likely Stall GROWTH Act

By Hannah Glover

As the investment community applauds the two-year extension of the 15% Federal tax rate on dividends and capital gains through 2010, which President Bush signed into law via the Tax Relief Extension Act of 2005 last Wednesday, Washington-watchers say it might be a while before investors can expect any further tax breaks.

And that means the progress on tax bills tailored to the mutual fund industry, such as the Generating Retirement Ownership Through Long-Term Holding (GROWTH) Act, might be stunted.

That bill, known inside the Beltway as HR 2121, would call for all taxes on mutual fund earnings to be deferred until a shareholder cashes out. Any dividends that are reinvested would likewise be tax deferrered according to the proposed bill, introduced by U.S. Representatives Paul Ryan (R-Wisc.) and William Jefferson (D-La.) last May.

The Investment Company Institute

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Federated Joins Quantitative Realm

MDT Play Reflects Industry's Institutional Push

By James M Amend

If the mainstream media were any indication, you'd think quantitative portfolio analysis would be to the mutual fund industry these days what technology stocks were in the late 1990s.

Although bubble-like enthusiasm is building, don't expect it to inflate overnight, experts say. And perhaps no recent industry development more accurately captures the nature of the "quant" upswing in the last few months than Federated Investors' acquisition of MDT Advisers, a relatively unknown stock picker in Cambridge, Mass.

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has championed the bill since its introduction, but also conceded it might be a two-year work in progress.

Others say it might be longer.

"The entire industry would clearly love to see the GROWTH Act pass," said Geoff Bobroff, president of Bobroff Consulting in East Greenwich, R.I. "But [it] is troubled because it tends to focus on one industry, and most tax legislation does not benefit a single provider. I think it's the right answer [for investors], but I don't know what the impetus would be to get Congress to support it."

One reason is that 60% of the 91 million Americans who invest in mutual funds do so through tax-sheltered accounts, such as 401(k) plans, and therefore are not affected by taxes on dividends and mutual funds — at least not now.

Another reason is the increasing Federal deficit, which is now estimated to be $371 billion, or $2,700 per tax return, according to the Washington-based Tax Foundation, a non-partisan research group.

"There's a great pressure in all of these tax bills to create an off-setting revenue source," said Neils Holch, executive director for the Coalition of Mutual Fund Investors, also based in Washington. "I think the focus right now is on extending current provisions on things slated to expire. I don't know if there's much money in the budget to do anything much more than that," Holch said.

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But that doesn't mean that the recent extension is the end of investor-friendly tax-cuts forever.

In fact, if there is a lesson to be learned from the recent extension of the law capping taxes on capital gains and dividends, it's that politicians are increasingly aware of a relatively new electorate: the individual investor.

"Things like this that might not have passed 10 or 15 years ago are able to pass now," Holch said. A big part of the credit for this increased power goes to mutual funds. Whereas, in the past, investing in stocks and bonds was only for the wealthy, mutual funds and 401(k) plans gave the middle class access to well-respected money managers, new capital markets and a reason to think of themselves not just as income-earners, but as investors, Holch said.

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Bobroff Consulting

And, as the recent extensions show, politicians know that once a tax break hits the books — even one written as a temporary reduction with a so-called sunset date — it's awfully hard to take it back.

However, it's also hard to justify new breaks when there's no easy way to make up the lost revenue, said Merideth Dodson, director of domestic campaigns for RESULTS, the Washington-based not-for-profit aimed toward ending hunger. In fact, Dodson argued, cuts like these don't lift the economy, but widen the gap between rich and poor.

"To have a 15% rate on taxation on what I consider unearned income when a teacher is paying a higher rate on earned income just to make ends meet is just not right," Dodson said.

But such an "us-against-them" mentality poses no serious political threat to the passage of the GROWTH Act, according to Max B. Sawicky, an economist with the Economic Policy Institute, a not-for-profit, non-partisan policy think tank.

"People are not so concerned when [other] people get a tax cut. They think it's a freebie, and there's not much outrage," Sawicky said. "The GROWTH Act will pass."

Opponents of the recent extension, and other tax cuts that target investors, say that such breaks only amplify the Federal deficit, and result in service cuts for those who need them.

"Every dollar of spending claims a tax dollar sooner or later, whether it's another [type of] tax or [to pay for] debt services. When you cut taxes without cutting spending, you're not cutting taxes broadly, you're shifting taxes to younger people," Sawicky said.

"So far, politicians have had a free ride with these tax cuts, because foreigners have been willing to lend us money. When they become more reluctant to buy more securities, that's when all the chickens will come home to roost in the U.S.," he continued.

And that's what politicians must think about before approving more cuts.

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"Looking down the road, we're going to have to close the gap. With double-digit growth in healthcare costs, it's hard to tell someone they can't have a healthcare benefit, new treatment or drug because now we can't afford it, which is just another way of saying, 'We don't want to raise taxes to pay for it,'" Sawicky said. "I don't envy any politician caught between those imperatives."

Proponents of investor tax relief packages say that the $49.4 billion New York-based **Standard & Poor's** estimates investors will save in dividends and capital gains taxes through the two-year extension, for example, pumps more money into the economy, and speeds recovery. Companies begin hiring, people increase spending, and the government, which as an institution is itself a major investor, also benefits.

It's important to keep this momentum going, said **Tom Roseen**, a senior analyst with **Lipper** of New York. Even with the cuts, mutual fund investors alone paid $15.2 billion on their gains to Uncle Sam last year, compared to $9.6 billion in 2004, Roseen said. And while that's a sign of sound market growth, if the tax rate were to revert to pre-2003 levels, investors would have less to spend, and may even pull back from the market, he said.

Furthermore, until last year, some investors were still offsetting their losses from the 2000-2002 bear market against their gains.

"As larger dividends are going out, some people might get a little bit of sticker shock when they open their 1099 [tax forms] next year," Roseen said.

If the laws hadn't been extended until 2010, it would be even worse.

While people like Dodson and Sawicky argue that such tax cuts only benefit the wealthy, Roseen argues that when it comes to investing, mutual funds are really a middle-class tool. "I don't think a lot of multi-millionaires are in mutual funds," he said. "They are more likely to be into managed accounts and other, more sophisticated tools."

"It's true that ownership is dispersed very widely, but it's also true that the size of the savings is based on the size of people's portfolios, and this tax cut is very concentrated," Sawicky said.

In fact, Dodson estimated that while the average savings to an investor whose income was $70,000 per year was $30, a millionaire would get a break of nearly $42,000.

Still, Roseen maintains that any money investors get to keep in their pockets — or, better, in their retirement or savings accounts — is good for the individual, and for the economy overall. He cites the bump in market performance since the 2003 cuts were first enacted. Sawicky, however, is less convinced that the cuts passed in 2003 were the cause of the market upswing.

"The last couple of years have been good," Sawicky conceded. But, to date, the recovery since the 2000-2002 bear market hasn't been as good as others, such as that of the mid-1990s, a time when taxes went up. "Economists like to look at the whole cycle and compare it to something you can standardize against," he said. "By that criterion, this has been a pretty crappy recovery."

But there is a chance the recovery has just begun, and, if anything, keeping taxes low for investors will accelerate it or keep it from flattening, Roseen said. "[While] we were lucky to get two years' extension, I'd love to see this become a permanent part of tax law." MME

Small-Cap Value: Top 10 Performing SMA Program (Retail) Managers

Managers ranked in trailing one year

Firm	Product	4th Q 2005	One-Year Trailing	Three-Year Trailing	Five-Year Trailing
Keeley Asset Mgmt.	Institutional Corporate Restructuring	0.73	23.02	31.43	19.43
GW Capital	Small Cap Value Equity	-2.13	20.14	38.10	24.29
Lord, Abbett	Lord Abbett Micro Cap Value	2.80	19.61	31.83	23.13
MDT Advisers	MDT Small Cap Value	0.56	18.87	31.76	17.97
Snyder Capital Mgmt.	Small Cap Value	4.33	17.37	24.30	19.20
Advisory Research	Small Cap Value	-2.54	17.00	28.34	19.29
Neuberger Berman	Small Cap Value Equity (Institutional)	-0.19	16.73	24.68	17.40
First Pacific Advisors	Small/Mid-Cap Absolute Value Equity	1.11	16.70	24.54	20.98
Wells Capital Mgmt.	Small Capitalization Value Equity	0.42	16.44	28.91	20.02
Davidson Investment Advisors	Small/Mid Cap Value	-0.44	15.82	23.58	12.44
Benchmark:	Russell 2000 Value	0.66	4.71	23.18	13.55

Source: CheckFree Investment Services' Möbius M-Search. Performance Returns are calculated with gross returns using the Möbius Investment Manager Data reported in CheckFree's M-Search®: Investment Manager Database System. Trailing Period Returns cover periods ending on the reported current quarter through the previous year indicated. Investment Style classifications are defined for each product set by Möbius through a combination of quantitative and qualitative processes. "SMA Institutional" categories include only institutional SMA product returns. "SMA Program" categories include retail SMA product returns. CheckFree Services Corp. makes no representations or warranties as to the accuracy of such data, calculations or rank listed or generated. MobiusData@CheckFree.com"