

INVESTING

Fund Control

Separate accounts are aiming lower and growing faster as mutual-fund rip-offs turn off investors

BY DANIEL KADLEC

EVEN BEFORE THE MUTUAL-FUND SCANDALS began unfolding in September, investors had been flocking to a little-noticed (but not so little) alternative known as the separately managed account. Clear fees and no hidden costs make these personalized portfolios more sensible than ever. No joke: they may one

day supplant common mutual funds as the investment vehicle of choice for millions of people. About \$500 billion resides in separate accounts. Yes, that's a long way from the \$7 trillion in mutual funds right now. But since the middle 1990s, assets in separate accounts, in which your money is set aside as a distinct pool, have been growing twice as fast as mutual-fund assets, in which your cash is commingled. According to estimates by the Money Management Institute, a trade group for private asset managers, separate-account assets should double in three years, triple in five years and hit \$2 trillion by 2011.

Is a separate account right for you? Once upon a time, you had to be a Vanderbilt or a Rockefeller to qualify. But just as hedge funds, private equity and other formerly exclusive alternative investments have become more broadly available in recent years, so too have separate accounts. Traditionally the minimum investment was \$1 million or more, and it still is at many firms. The fund company **T. Rowe Price** requires \$2 million to get into a separate account.

But **Bank of America**, Smith Barney,

Merrill Lynch and others have begun to offer separate accounts with minimums as low as \$100,000. And some enterprising investment managers, like Denver-based **Curian Capital**, have pushed the minimum down to just \$25,000, using sophisticated software that allows the firm to buy fractions of shares. Anyone considering separate accounts should have resources to open at least three to spread risk across different funds, which with most separate-accounts managers will require up to \$300,000. That's no small sum. But it's not J.P. Morgan material either, and given the abusive practices we've seen at mutual funds (trading schemes that harm long-run investors and hefty, complex fees), anyone who qualifies should take a look.

Separate accounts are a lot like mutual funds. Different managers have different styles, from large-cap equity income to small-cap aggressive growth. There are also fixed-income separate ac-

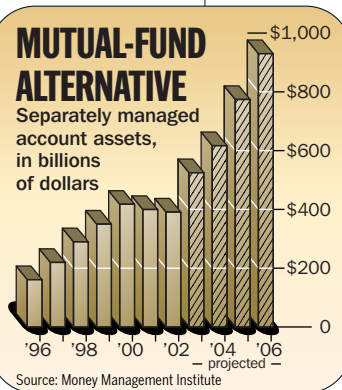
counts. Your cash is invested along the same lines as that of countless other separate-account holders, with one exception: you get to fine-tune. Maybe you have an issue with tobacco. Or you might want to avoid stocks of companies in the industry in which you work—so that if the entire sector crashes, you don't lose your investment along with your job. Just say the word, and your manager will purge your portfolio of such securities.

Another benefit: because you can customize your portfolio, you are able to minimize your tax bill by, say, instructing the manager to sell a losing stock in the separate account to offset a gain you have in another account or even another asset like real estate. This makes separate accounts most useful for taxable savings.

Then there is fee transparency. Typically,

separate-account managers charge a flat annual fee of 1.5% to 2.5% of assets. In most cases there are none of the loads, redemption fees, 12b-1 marketing fees, trading commissions or soft-dollar costs that proliferate in the mutual-fund world and drive annual expenses far higher than disclosed levels.

Interestingly, despite the growth in separate accounts a FundQuest study shows that returns from mutual funds and separate accounts closely track. That suggests that overall costs are about the same. What attracts clients is the ability to customize and control. "Savvy investors recognize that mutual funds do not deliver this way," says Christopher Davis, executive director of the Money Management Institute. If you like to know exactly where your money is going, separate accounts win hands down. ■



Reprinted through the courtesy of the Editors of TIME Magazine © 2004 Time Inc.

The Money Management Institute
www.MoneyInstitute.com