

Explosion of Activity in No-Load Funds by Cliff Pletschet

Independent investors love “no-load” mutual funds because they can be bought directly from the funds without paying a commission to an intermediary. But as no-loads flood the marketplace like a ravaging river, we may be seeing too much of a good thing.

They are showing up everywhere, in brokerage accounts, variable annuities, variable life contracts, 401(k) plans, financial planner plans and managed accounts. There seems to be no end to their proliferation and at least two problems immediately arise:

- 1) Many of the funds are relatively new, having just been created to satiate the public feeding frenzy and thus have no meaningful track record.
- 2) Many end up inside wrappers that trigger additional costs and thus some of the “no-load” luster is lost. If the investor is aware of and accepts the sometimes half-hidden cost, then there’s no problem.

“No-loads are spreading like wildfire, but the danger is that 60 to 70 percent have been in business less than five years, says James Demmert, managing partner for Main Street Research, a portfolio management company based in Sausalito.

Wise Investors look for pure no-load funds that have been in business at least 10 years and have a good and consistent record, says Demmert. Good.

If the investor deals directly with the fund or buys them short of a commission in a discount brokerage account, then the investor knows exactly what he or she is paying.

The number of “commission-free no-loads” sold by discount firms grows daily. As last count, Jack White offered 541; Fidelity Investments, 350; Charles Schwab, 342, and Waterhouse Securities, 180. There are no hidden charges here unless you consider the small fee that the funds pay the brokers to have their funds included in a broker’s corral.

A growing number of financial planners are using no-loads in plans that are either created for an hourly fee or a one-time charge. Some have even expanded into managing accounts of no-loads for an annual fee. The caveat here is: know what the fee

structure is and do some comparison shopping.

Main Street Research uses no-loads with good long-term records and they charge an annual management fee of only 1 percent, probably the lowest in the country. They struck a deal with Charles Schwab, splitting that 1 percent and domiciling the funds at Schwab.

So with Demmert picking up only one-half of 1 percent we know he is not gouging the public. Main Street Research was up 14 percent in 1993, 4.21 percent last year and 8.3 percent in the first quarter of this year, says Demmert. The big catch: you need to invest at least \$500,000.

Perhaps the biggest uncertainties as to performance and cost lie in the inclusion of no-load funds in variable annuities and variable life contracts of insurance companies.

Here’s where the proliferation is going at break-neck speed because insurance companies, by law, cannot adopt existing funds. New one must be created for them. So buyers of variable annuities and variable life are not likely to be treated to seasoned funds.

On top of that, the annual mortality charges that insurance companies pile on top of the regular annual fees of the funds is not always immediately apparent.

Some sellers have been sending me information on variable life insurance. I’m still studying the material, but “insurance” remains a turn-off to me when combined with investment products.

In 401(k) workplace plans, no-load funds might not present uncertainties as to cost and seasoning. But the problem often is that the employer’s provider is not offering quality funds.

A problem lurks even among the no-loads with good long-term records. It’s called overexposure. How much longer can these funds continue to suck in new money and continue to buy stocks that keep on providing good returns?

There’s still a lot of people out there NOT in mutual funds. A Janus Funds Super Bowl television commercial triggered 49,000 phone calls.

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