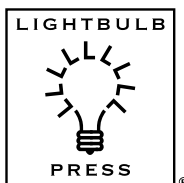


YOUR GUIDE TO MANAGED ACCOUNTS

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Managed Account Basics

A managed account is a handy tool for investing your assets.

Managed accounts attract investors who may be uncertain about which securities to choose for their portfolios, how long to hold onto the securities they have, and when to sell. That's because, in a managed account, those decisions are made by a professional investment manager, as they are in a mutual fund. In fact, the manager monitors the portfolio continuously to stay on top of new opportunities.

And like a mutual fund, each managed account has a clearly defined objective. That's an added enhancement for people who recognize the importance of goal-oriented investment decisions.

An official objective also allows investors to identify a benchmark against which to judge progress toward their goals—or react to lack of progress. That benchmark might be a well-known stock market index, such as the Standard & Poor's 500-Stock Index (S&P 500), or a personalized standard defined with the help of a financial adviser to reflect the investor's goals and objectives. Some industry experts describe such a personalized benchmark as a **family index**.

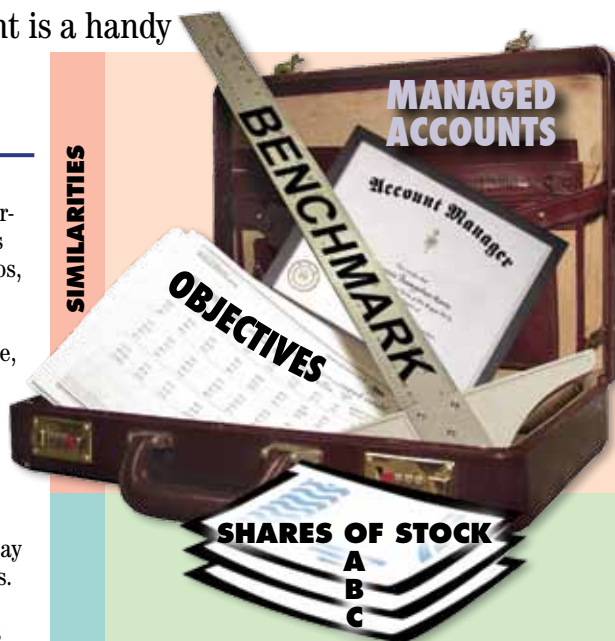
But while managed accounts and mutual funds share these key features, their differences are more significant than their similarities.

WHAT YOU OWN

One critical difference is that if you invest through a managed account, you own the individual securities in your account. The amount you have invested in each security is determined by:

- The total value of your investment
- The number of different securities in the account
- The way the investment manager diversifies your assets

SIMILARITIES



DIFFERENCES

- You own shares in individual securities
- You have no phantom gains
- You can time capital gains or losses
- You can avoid or include certain investments
- You always know which investments are in your account

In contrast, if you invest in a mutual fund, you have equity in the total fund portfolio, in proportion to the number of fund shares you own. But you don't own shares in the individual securities that make up the portfolio.

HAVING IT YOUR WAY

One advantage of individual ownership is that your managed account can be customized to achieve better diversification in your overall portfolio or to exclude investments you'd prefer not to own.

For example, if you own your employer's stock in your retirement savings plan, you and your adviser might decide not to invest additional assets in that company. Or, you may request that certain securities you've put into the account not be sold.

Although you can probably find funds that invest in a way that's compatible with your political, social, or religious beliefs, you can't ask a mutual fund not to buy or sell a particular stock, whatever your

gain qualifies for the lower long-term capital gains tax rate, mutual fund managers often sell assets in less than a year. Any short-term capital gains passed on to you are taxed at your regular tax rate.

Further, mutual fund managers are sometimes forced to sell shares if shareholders want to redeem substantial holdings. Any capital gains that result are passed along to you as well, potentially increasing the tax you owe.

You might also have long-term capital gains on the sale of securities that the fund has owned for a long time if they've increased significantly in value. Of course, if you've been a shareholder for most of the period, you've shared the benefit of the growth on which you owe tax. But if you've purchased shares only recently, you still owe tax on the gains allocated to your shares even though you didn't benefit from the security's increasing value. In fact, the price you paid for your shares reflected that increased value. Those factors produce what are known as **embedded** or **phantom gains**, but the taxes they provoke are very real.



- You own fund shares not individual securities
- You're vulnerable to phantom gains
- You have no control over capital gains or losses
- You have no influence on fund portfolio
- You learn quarterly what investments the fund owns as of that reporting date

reason. What's more, you may not know which securities the fund owns at any given time. Each fund is required to report its holdings quarterly, but its manager can buy and sell at any time between when one report is issued and the next one is due—and most do.

THERE ARE ALWAYS TAXES

One of the few downsides of accumulating wealth is paying income or capital gains taxes on your investment earnings. But investing through a managed account may protect you from some of the unexpected tax consequences of owning mutual funds.

Many mutual fund managers turn over securities in their portfolio regularly, taking profits or cutting losses. Unlike tax-conscious investors, who may wait to sell appreciated assets until the

are no phantom gains. That's because your cost basis in a security is its price the day that security was added to your account. When the security is sold, your gain or loss depends on the difference between the selling price and your cost basis. And if some other investor sells shares in an account run by your investment manager, the transaction has no effect on your account.

Another advantage of managed accounts is that you can ask your investment manager to sell securities that have dropped in value if you can use the capital losses to offset capital gains you've realized during the year. Or you can request that any selling be postponed into the next tax year to limit potential capital gains on investments that have increased in value.



Investing for Groups

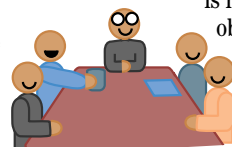
Foundations, endowments, and retirement plans need financial advice too.

Being responsible for your own financial security and the security of your family is one of the main reasons for choosing managed accounts for your personal portfolio.

If you're responsible for the financial security of an organization—either as the person making its investment decisions or as part of a decision-making team—it may make sense to depend on managed accounts for the same reason. In fact, endowments, foundations, and retirement plans have an even longer history of depending on investment managers than most individuals.

There are a number of reasons for groups to seek investment expertise:

- Their financial needs may be complex, especially if they must balance the need for ready money to pay for current obligations with the goal of growing their asset base to keep them viable in the future
- Any investment decisions may have to be acceptable to, or approved by, the board of directors or trustees
- There may be legal obligations to make appropriate investments or avoid unacceptable choices



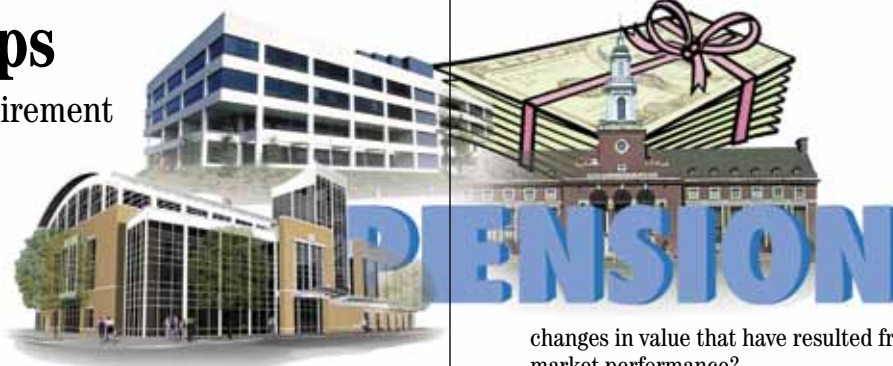
BEING LIQUID ENOUGH

Groups that must have cash available on a regular basis to meet current obligations, while at the same time investing for growth to ensure adequate resources for the future, are the rule rather than the exception. Foundations, for example, must typically pay out a certain minimum percentage of their assets—often 5%—each year. Retirement plans, such as the union-sponsored, multi-employer Taft-Hartley plans that are negotiated in collective bargaining agreements, must have cash available, often on a monthly basis, to make payments to retired workers.

One of the choices these groups face is how to liquidate assets to meet their obligations. Do they simply sell off the required percentage across all their managed accounts? Do they liquidate the weakest holdings or the strongest ones? Do they use the need for cash as an opportunity to reallocate their overall portfolio, adjusting for



affect decision making. An adviser is often able to deal more effectively with those tasks than an insider.



changes in value that have resulted from market performance?

Those kinds of decisions, with their long-reaching consequences, demonstrate the value of combining experienced investment consulting with the flexibility of a managed account. A consultant, using the quarterly reports provided by the investment manager, can explain why certain investments or asset classes provide the current returns they do. He or she can also evaluate the impact of buying or selling certain investments rather than others on asset allocation and future portfolio performance.

Because an investment manager has the flexibility to sell specific investments in your group's account to meet your liquidity or other needs, you have much more control over your assets than if they were invested in mutual funds, at the same time that you have the protection of a diversified portfolio. Similarly, any trades that your investment manager authorizes to meet other clients' needs would have no effect on your group's account, since the assets in each account are owned separately.

An adviser may also be in a better position than members of the financial committee to explain the importance of asset allocation and portfolio diversification to achieving



A LITTLE HELP FROM ERISA

Employer sponsored benefit plans, including pension, 401(k), insurance, and scholarship plans, operate under much stricter rules than other groups with assets to invest. These rules are laid out in the 1974 Employee Retirement Income Security Act, typically shortened to ERISA.

Despite its complexity, ERISA's reach extends beyond employer plans, increasingly serving as the standard by which the actions of most investment consultants and financial advisers are evaluated. In that way, ERISA has encouraged the development of managed accounts by endorsing the use of expert investment managers as the only prudent course of action.

A CONSULTANT CHECKLIST

If you're part of a group responsible for working with a financial adviser, here are some of the things you'll want to consider before you choose one:

- Experience, including time on the job, assets being managed, and professional credentials
- Fees and other expenses
- Availability for consultation
- Frequency and clarity of reporting
- Research, oversight, and monitoring processes used to identify and evaluate investment managers

long-term goals. He or she may also be more successful in helping the group pin down its risk tolerance and establish the ground rules for its financial decisions.

Finally, the adviser can monitor what's happening in the group's overall portfolio as well as in the managed accounts that are included in the portfolio. Among other things, this oversight helps to keep costs in check. But perhaps the adviser's most important contribution is to forestall hasty responses to volatile or depressed markets and to fight inertia in the face of consistently sub-par investment performance.

