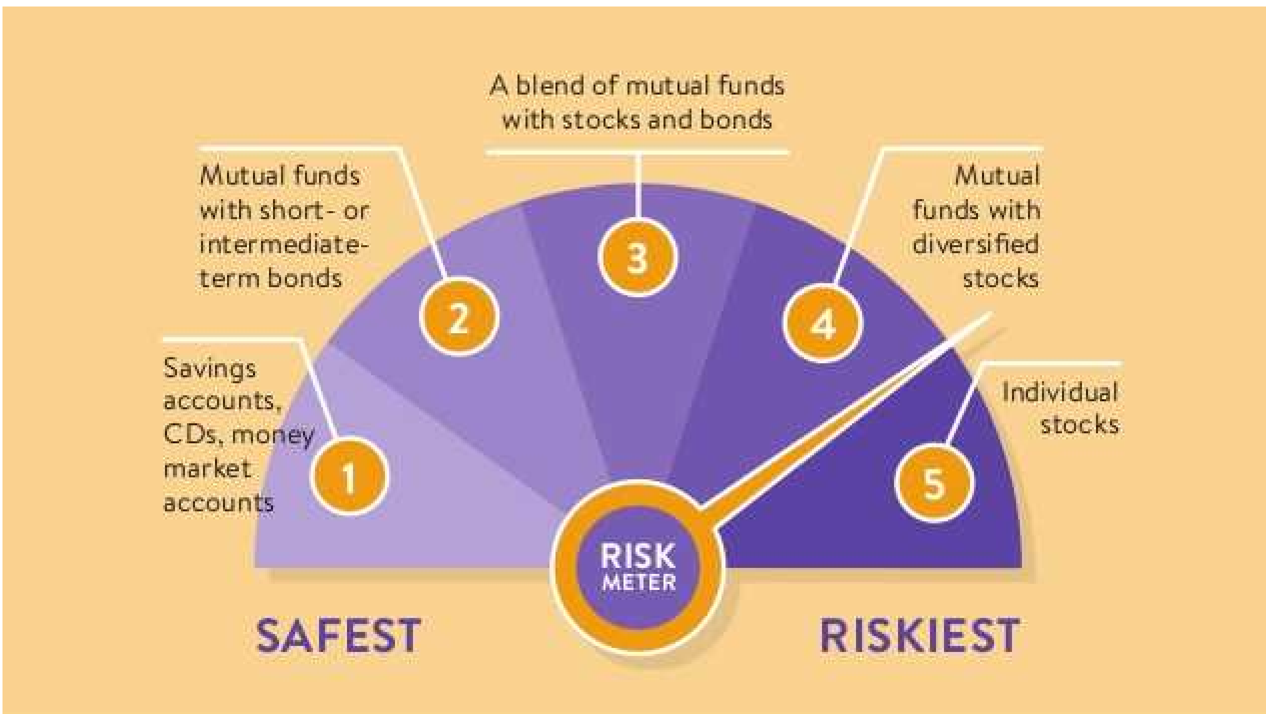
WHITE PAPER

A REVIEW OF INVESTMENT "VEHICLES" FOR PHYSICIANS



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Any medical professional who wants to save money for retirement or plan for a child's education needs to understand the basic tenets of investing. It allows them to improve the prospects of meeting future financial goals.

INTRODUCTION

In general, medical professionals are able to access these securities either directly with a brokerage account or through a separate account manager buying securities for them on a discretionary basis.

However, many physician investors who are building their own investment portfolio [ME, Inc], or are working with a financial advisor, will have a host of different investment vehicles (e.g., mutual funds or variable annuities) available which provide indirect exposure to the basic security types discussed above. When one of these investment vehicles is considered for investment, it is important for the medical professional to understand the characteristics of that vehicle, its cost structure, and the cash flows and valuations represented by the underlying investments of the vehicle.

[A] Separate Account Management

Separate account management offers medical professionals customized personal money management services. In the typical separate account structure, a money manager invests the individual's assets in stocks and bonds (as opposed to mutual funds providing exposure to specific asset classes) on a discretionary basis.

For healthcare providers with significant investment assets (e.g., $100,000), a separately managed portfolio can be customized to reflect their tax situation, social investment guidelines, and cash flow needs. An additional benefit of the separate account management structure is that a client's portfolio may be positioned over time as opportunities arise, rather than forcing stocks into the portfolio without regard to current conditions.

Although separate account management generally offers a higher degree of customization than mutual funds, fees for separate account management are generally consistent with mutual funds fees, especially given that separate account managers may discount their fees for larger portfolios.

[B] Mutual Funds

Mutual funds are one of the most common investment vehicles available. A mutual fund is an investment company registered with the Securities and Exchange Commission (SEC) under the Investment Company Act of 1940 investing in securities in a manner consistent with the fund's prospectus on behalf of its shareholders.

In other words, a mutual fund represents (equity) ownership of a company that is regulated by the SEC and makes investments based upon the terms outlined in its prospectus. Mutual funds generally provide investors diversified exposure to the securities markets at lower investment amounts than separate account management. In fact, the minimum investment in many mutual funds is as low as $2,000.

Thus, by pooling assets from multiple investors in an investment vehicle managed toward a broad goal such as capital growth (as opposed to a customized goal unique to each investor), mutual funds are able to offer investors access to areas of the financial markets that they would not otherwise be able to gain due to minimum investment restrictions.

The prospectus is a legal document describing the objectives, guidelines, restrictions and disclosures of the investment company. A key reason why mutual fund advertisements end with a statement similar to "read the prospectus carefully before you invest" is that this document governs the management decisions made for shareholders. Typically, the prospectus will provide the investment manager of the mutual fund wide latitude in the types of securities that may be purchased in the mutual fund. A fund that focuses on domestic equity investments may have flexibility to allocate significant portions of assets to foreign stocks, bonds, derivatives, etc.

Therefore, while mutual funds are often separated in databases and by the media into categories reflecting the basic type of investments their managers may focus on, these broad categories may fail to capture the broad flexibility and wide array of investments in any one of the funds within a category.

MUTUAL FUND TYPES

There are currently more than 10,000 mutual funds, as reported by CDA/Wisenberger, the leading provider of mutual fund information services to financial professionals. Two basic types of mutual funds are open-end and closed-end.

Closed Funds

A closed-end mutual fund that is traded in the stock market like as any other equity security, with buy and sell prices established by supply and demand for the security. Thus, in contrast to an open-end fund, a closed-end fund may possibly trade at a substantial discount, which means at a price below its NAV, or even at a premium, which means a price above its NAV.

Open Funds

An open-end mutual fund is a mutual fund that accepts new investors and allows investors to sell the fund at a specific price determined by the investor's prorated share of the market value of the fund. That price, known as net asset value or NAV, represents the market value of the mutual fund's portfolio less any accrued liabilities (e.g., management fees). The NAV is calculated once a day and governs all transactions until the next closing price.

. The following general criteria may be used to help select a domestic open-end fund:

1. Review the fund's track record back since inception, especially reviewing results in the bear stock market of 2008.
2. Examine the total fees charged by reading the prospectus.
3. Examine risk-adjusted performance relative to the appropriate index benchmark.

The debate about fund fees is often perplexing to the medical profession. Load (commission based) funds are not necessarily bad, and no-load (non-commission based) funds are not necessarily good. In fact, one might even argue that there is no such thing as a no-load (expense) fund, since all have fees associated with them, disguised under various terms. These include management fees, advisory fees, 12b-1 fees, redemption fees, low load fees, diminishing (vanishing) loads, operating expenses, marketing, sales and advertising fees, etc. As a general rule, the aggregate fee for a mutual fund should probably not exceed about half percent for a domestic bond fund, 1 percent for a domestic stock fund, 1.5 percent for an international fund, and about 2 percent for an emerging market fund. The lower the fees, the more money a medical professional will keep in his or her pocket. There are generally three types of open-ended mutual fund class shares;

1. Class A is a front loaded fund which offers break points for volume discounts. The more money invested, the lower the load. It is not wise to invest in a front load fund if you plan to cash out within a couple of years. For a true long-term investor however, it might be smarter to use Class A funds, since your costs are spread out over the number of year you hold the fund. These funds are sold with a commission (load) by brokers. A medical professional can also buy these funds without the upfront commission through discount brokerage firms like Schwab, Fidelity, and TD Ameritrade.

2. Class B fund, or back end load, shares have an exit fee associated with them that usually diminishes after five or seven years. They typically have higher annual yearly operating fees than Class A shares, but are reduced after the seventh year surrender penalty has elapsed. A medical professional can also buy these funds without the upfront commission through discount brokerage firms like Schwab, Fidelity, and TD Ameritrade.

3. Class C fund, or level load, shares do not have an initial sales charge, but may have higher 12b-1 or operating expense fees, on a deferred basis, as well as a deferred sales charge depending on the date of redemption. A medical professional can also buy these funds without the upfront commission through discount brokerage firms like Schwab, Fidelity, and TD Ameritrade.

Closed-end funds trade on the stock exchanges, much like a stock. One item of note for a medical professional is the annual fees charged by closed-end funds.

For closed-end funds, the average expense ratio is 1.39 percent for a domestic stock fund, 1.95 percent for a foreign stock fund and 1.19 percent for a bond fund according to the December 2000 Morningstar Closed End Fund database. While sales charges do not apply to closed-end funds, there are transactions costs such as brokerage commissions that apply to the purchase/sale of a closed-end fund.

Other sources of mutual fund information and evaluation:

No-Load Mutual Fund Investor
Sheldon Jacobs
www.noloadfundinvestor.com

Morningstar Mutual Funds
225 West Wacker Drive
Chicago, Illinois 60608
800-735-0700
www.morningstar.com

Value Line Mutual Fund Survey
220 E. 42nd. Street
New York, NY 10017
800-535-8760
www.valueline.com

Free Edgar
Corporate 10-K reports, filed annually with the SEC, are available at:
www.freeEdgar.com, as well as from: www.edgar-online.com and: www.sec-gov.com.

These databases will tell you fascinating tidbits about company financial statements, investments, executive perks and other corporate shenanigans, before you invest money in them. For example, Apple Computer nearly halved its finished goods inventory to $16 million, from $30 million, in the last quarter of Y 2000, while it took a charge of $90 million or so it could buy the late CEO, Steve Jobs, an airplane.

[C] Exchange Traded Funds

Exchange Traded Funds (ETFs) or tracking stocks are essentially index funds that are traded on an organized stock exchange. ETFs provide investors with broad exposure to economic sectors, market indices, including foreign stock markets. Examples of common ETFs include Spiders (SPY - tracking the S&P 500), Diamonds (DIA - tracking the Dow Jones Industrial Average), and Cubes (QQQ - tracking the NASDAQ 100). Beyond their diversification benefits, ETFs also allow investors the opportunity to take advantage of intra-day price fluctuation in various indices since the shares are traded just like individual stocks on the major exchange markets.

In contrast, an open-end index mutual fund can only be traded at one price (i.e., NAV) determined at the end of the day. Furthermore, the fact that ETFs are traded on an organized exchange means that investors can short the shares (i.e., bet that the relevant index will go down), buy the securities on margin, and enter market, limit, and/or stop orders. ETFs typically have low expense ratios given the passive investment approach used in managing the underlying securities. A passive investment approach is the same as indexing. There are currently 1,439 ETFs on the three primary stock exchanges as of 3/31/2013. Assets have now reached a record level of $1.47 trillion in assets. The primary advantages to ETFs are;

- **Cost effectiveness**: the average total expense ratio for ETFs globally is a mere 0.31 percent on an annualized basis.
- **Diversification**: total exposure to an entire index or benchmark.
- **Flexibility**: trade and settle like stocks, with intraday pricing and trading, place stop and limit orders, increments of one share and go long or short like a stock.
- **Transparency**: typically the full list of holdings is published daily.

ETFs also provide a primary method for an investor to practice passive investing, through index funds. "Indexing" is a passive form of management that has been triumphant in outperforming many actively managed mutual funds over the preceding 30 years. While the most popular index funds track the S&P 500 stock index, a number of other index funds focus on less popular benchmarks. This includes the Russell 2000 Index (small companies), the Dow Jones Wilshire 5000 Index (total stock market), the MSCI EAFE Index (foreign stocks in Europe, Australasia, Far East) and the Barclays Capital Aggregate Bond Index (total bond market).

The principal advantage to such an approach is the lower management expense ratio on an index fund. Also, a majority of mutual funds fail to beat broad indexes, such as the S&P 500. The thinking behind index funds has much academic essence to it.

A theory known as Efficient Market Hypothesis (EMH) also follows what is known as the “random walk” thesis. The random price action of the stock markets was first discovered by a French broker Jules Regnault in 1863. It was further highlighted in a 1900 PhD thesis, "The Theory of Speculation" by Louis Bachelier.

What is today known as the formal “efficient-market hypothesis” was developed by Professor Eugene Fama at the University of Chicago Booth School of Business. Professor Fama published his Ph.D. thesis in the early 1960s that examined in detail this random walk process. In 1975, John Bogle of Vanguard took the position that "if you can't beat 'em, join 'em" and created the first low-cost mutual fund that mirrored the S&P 500 index. This was the first true “index” fund.

It has been a successful launch for Mr. Bogle. Since he started the first index fund in 1975, anywhere from 50%-80% of active mutual funds get beat by the market in any given year.

The chief raison d'être for this fact is the higher costs that mutual funds charge on an annual basis. A fund's total return each year is the total return of the portfolio minus the fees an investor pays for management and fund expenses. If an active mutual fund charges 2%, then an investor must outperform the market by that amount just to be even.

The advantage of index funds, especially through the ETF vehicle, is the low absolute costs. An average non-index fund has an expense ratio of around 1.5%, whereas many ETF index funds have an expense ratio of around 0.2%. The explanation the costs are lower in an index fund occurs because the fund is not actively managed. A medical professional should always realize that investing in an index fund doesn't guarantee no loss of money. You will in fact lose money in a poor stock market. But given the fact that index funds do outperform most actively managed mutual funds, any investor should give consideration for at least part of their portfolio residing in a low cost option.

CONCLUSION

This paper reviewed a wide range of investment vehicles for the physician-investor and medical professional.

Acknowledgements

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