

FR2014-0721-0351/E

September 19, 2014

## How Wealthy People Invest

1. There is no offer of a prospectus in this document. The language which confused the reviewer has been removed. (page 9)
2. The verbiage "How Wealthy People Invest" and "Secrets of professional Money Management" has been changed to: **How Wealthy People Use Professional Money Management (pages 1 and 2)** and the footnote for substantiation has been added

Most households that own mutual funds have moderate family incomes, Investment Company 2013 Fact Book, p. 94 [www.ici.org/pdf/2013\\_factbook.pdf](http://www.ici.org/pdf/2013_factbook.pdf). Alternatively, only 1% of respondents worth \$5 million to \$10 million invest in mutual funds....among those worth \$20 million or more, NONE invest in mutual funds.... Study by Prince and Associates, <http://blogs.wsj.com/wealth/2007/06/12/how-the-rich-invest/>

3. This verbiage has been deleted "To address the disadvantages above, Wall Street created **Exchange Traded Funds**" (page 4)
4. The following disclosure has been added: (note that diversification does not ensure a profit or guarantee against loss.) (page 3)
5. Add footnote 2: **The Real Cost of Owning a Mutual Fund, Forbes 4/4/11**  
<http://www.forbes.com/2011/04/04/real-cost-mutual-fund-taxes-fees-retirement-bernicke.html> (page 3)
6. Verbiage added: **Do note that to trade ETFs, the investors pays a commission for the transaction.** (page 5)
7. Verbiage added: **(Please consult with a tax advisor as the information below s a general discussion).** (page 4)
8. This paragraphs has been added: **Caution**

**Some separately managed accounts invest in mutual funds or other registered investment companies and may thereby subject the investor to 2 sets of fees – the advisory fee for the separately managed account itself plus the management fees and expenses of the underlying registered investment companies. (page 6)**

9. The words "perfect" and "perfectly" have been removed (page 6)
10. The statement on fees regarding separately managed accounts has been replaced with this statement: **Mutual funds often charge sales loads, management fees and service fees while separately managed accounts typically charge an all-inclusive "wrap" fee. And this substantiation, footnote 6:**

MFS Investment Management, "Is a Separately Managed Account for You?" *December 2013* MFS Investment Management, "Is a Separately Managed Account for You?" *December 2013*  
<https://www.mfs.com/wps/portal/mfs/us-investor/products/separately-managed-accounts>

11. This verbiage "providing protection" has been replaced with:- **potentially reducing risk**
12. Added extensive table of comparisons Mutual funds, ETFs and Separately Managed Accounts (pages 8 and 9)



Financial Industry Regulatory Authority

September 19, 2014

Anna Lautenbach  
Packerland Brokerage Services, Inc.  
432 Security Blvd  
Green Bay WI 54313

Reference: **FR2014-0721-0351/E**

Org Id: 37031

**REVIEW LETTER**

1. How Wealthy People Invest  
Rules: FIN 2210, SEC 482  
9 pages

Fee: \$125

Total Fee: \$125

Attention: Anna Lautenbach

Revisions are necessary for this material to be consistent with applicable standards.

The prospectus offer on page 9 must be revised to more closely track the language required by SEC Rule 482(b)(1).

In addition, the prospectus offer must be presented in a type size at least as large as and of a style different from, but at least as prominent as, that used in the major portion of the material, in accordance with SEC Rule 482(b)(5).

The title "How Wealthy People Invest" and "The *Secrets* of Professional Money Management" (emphasis added) on pages 1 and 2 is unwarranted as they lack basis. Therefore, they must be revised, pursuant to FINRA Rule 2210(d)(1).

In addition, the claim "To address the disadvantages above, Wall Street created Exchange Traded Funds" on page 4 lacks basis and must be deleted, pursuant to FINRA Rule 2210(d)(1).

The material must be revised to address the following, pursuant to FINRA Rule 2210(d)(1)(A):

- To balance the reference to diversification in the "Mutual Funds" discussion on page 3, an explanation must be included to the effect that diversification does not ensure a profit or guarantee against loss.

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- A basis for the “Money Magazine” discussion on page 3 must be provided (e.g., date of article, time period, etc.).
- To balance the language “...the cost to manage the fund and the fees to the investor or much smaller” in the “Exchange Traded Funds (ETFs)” discussion on page 5, an explanation must be included to the effect that commissions are charged on every trade.
- To balance the tax discussion throughout the material, an explanation must be added to advise the reader to consult with a tax advisor.
- To provide a sound basis for evaluating the facts, the “Separately Managed Accounts” (SMAs) discussion on page 6 must be revised to include an explanation to the effect that some SMAs invest in mutual funds, or other registered investment companies, thereby subjecting investors to two sets of fees: the advisory fee for the SMA itself plus the management fees and expenses of the underlying registered investment companies.

The following claims are unwarranted and must be deleted, pursuant to FINRA Rule 2210(d)(1)(B):

- The reference to perfectly in the statements “Mutual funds are perfectly designed for the small investor...” and “Secondly, mutual funds offer perfect liquidity...” on page 3.
- “Fees vary widely and can be comparable of open-end mutual funds or more reasonably comparable to those of an ETF” on page 6.

The language “...and providing *protection* to your principal” (emphasis added) in the “Mutual Funds” discussion on page 3 is promissory and must be revised, pursuant to FINRA Rule 2210(d)(1)(B).

The comparison between mutual funds, exchange traded funds, and SMAs throughout the material must disclose all material differences between them, including (as applicable) investment objectives, costs and expenses, liquidity, safety, guarantees, or insurance, fluctuation of principal or return, and tax features, pursuant to FINRA Rule 2210(d)(2).

The material must be revised to clarify and reflect any relationship between the member (Packerland Brokerage Services, Inc.) and any non-member (P&R Associates, Financial Educators, Inc.), pursuant to FINRA Rule 2210(d)(3)(B).

In addition, the communication should clearly state that Mr. Petcka is a registered representative of Packerland Brokerage Services, Inc., pursuant to FINRA Rule 2210(d)(3)(B).



Financial Industry Regulatory Authority

Reviewed by,

Natlyn D. Murrain  
Senior Analyst

hrm

***This year's Advertising Regulation Conference will be held on October 9-10 in Washington, D.C. For more information and to register, please view our online brochure at <http://www.finra.org/conferences/adreg3>.***

***NOTE: This review is limited to the communication that was filed. We assume that the communication does not omit material facts, contain statements that are not factual, or offer opinions that do not have a reasonable basis. This communication may be described as "Reviewed by FINRA" or "FINRA Reviewed"; however, there must be no statement or implication that this communication has been approved by FINRA.***

***Please send any communications related to filing reviews to this Department through the Advertising Regulation Electronic Filing (AREF) system or by facsimile or hard copy mail service. We request that you do not send documents or other communications via email.***

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# How Wealthy People Use Professional Money Management



Provided to you by

# How Wealthy People Use Professional Money Management<sup>1</sup>

Written by Financial Educators

Provided to you  
by

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<sup>1</sup> Most households that own mutual funds have moderate family incomes, Investment Company 2013 Fact Book, p. 94 [www.ici.org/pdf/2013\\_factbook.pdf](http://www.ici.org/pdf/2013_factbook.pdf). Alternatively, only 1% of respondents worth \$5 million to \$10 million invest in mutual funds....among those worth \$20 million or more, NONE invest in mutual funds.... Study by Prince and Associates, <http://blogs.wsj.com/wealth/2007/06/12/how-the-rich-invest/>

# Introduction

Just as surgeons don't operate on themselves, wealthy people usually do not invest their own money. They have investment professionals manage their money for them.

In this booklet, we will discuss three types of professional money management and the differences between each. We will look at mutual funds, exchange traded funds and separately managed accounts, and the pros and cons of each.

## Mutual Funds

### Advantages

Mutual funds are ~~perfectly designed~~ suitable for the small investor because most accept small investment amounts, typically \$2500 or less. Secondly, mutual funds offer ~~perfect~~ liquidity with the ability to add or withdraw from your account at the end of any day. Additionally, the money is invested by an individual or team of individuals who are typically experienced investors, have a tested investing methodology, and have typically earned the Chartered Financial Analyst credential. This is a rigorous program of study, far more comprehensive than the exams a financial advisor or investment advisor must pass. So far, mutual funds appear to be an easy investment for any type of investor.

Maybe most important is diversification. Mutual funds may have from 30 to 500 different stocks in the fund thereby diversifying your money and ~~providing protection~~ potentially reducing risk to your principal. Should a couple of companies in the mutual fund do exceptionally poorly; the poor performers will not have a large impact on a big portfolio (~~note that diversification does not ensure a profit or guarantee against loss.~~) However, there are investors who would prefer not to use mutual funds as explained under the disadvantages section.

### Disadvantages

**Fees:** One of the often cited complaints about mutual funds is that of heavy fees. A summary of costs from various reaserch studies calculated the average cost of owning a domestic equity fund at 3.17% annually in a non-taxable account. This does not include the cost of any front end or back end cost, redemption fees or 12b-1 fees.<sup>2</sup> A similar study by the SEC concluded that average fees were lower.<sup>3</sup>

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<sup>2</sup> The Real Cost of Owning a Mutual Fund, Forbes 4/4/11 <http://www.forbes.com/2011/04/04/real-cost-mutual-fund-taxes-fees-retirement-bernicke.html>

<sup>3</sup> <http://www.sec.gov/news/studies/feestudy.htm>.



**Turnover and Taxes:** Closely related to the issue of high fees is the issue of portfolio turnover and income taxes. (Please consult with a tax advisor as the information below is a general discussion).

The turnover rate (frequency of purchases and sales) in a fund is not necessarily a bad thing but it does increase your tax bill if the fund is selling stocks with lots of short-term gains. Additionally, turnovers cost you money. If turnover does hurt a fund's return, wouldn't there be a correlation between a fund's turnover rate and its after-tax return? Indeed there is!<sup>4</sup>

To optimize your mutual fund returns, or any investment returns, know the effect that taxes can have on what actually ends up in your pocket. Mutual funds that trade quickly in and out of stocks can have what is known as "high turnover." While selling a stock that has moved up in price does lock in a profit for the fund, this is a profit for which taxes have to be paid. Turnover in a fund creates taxable capital gains, which are paid by the mutual fund shareholders.

The SEC requires all mutual funds to show both their before- and after-tax returns. The differences between what a fund is reportedly earning, and what a fund is earning after the investor pays taxes on the dividends and capital gains, can be tangible. If you plan to hold mutual funds in a taxable account, please check out these historical returns in the mutual fund prospectus to see what kind of taxes you might be likely to incur.

If you would like to know if your funds have high turnover and resulting high tax impact, please call for a free analysis on the funds you own. Next we have the issue of style drift.

**Style Drift:** Did you know some funds might borrow money to buy securities? Are you comfortable knowing that these funds may borrow money (in an effort to buy more stocks and enjoy gains), which could magnify losses if the market falls? Do you know if your fund uses volatile derivatives in order to boost returns? Derivatives are financial instruments, whose up and down price movements are based on the movements of an underlying security, such as a stock or bond. However, the derivative's volatility is usually greater. If the stock moves 10% in value, the derivative could move even more. These issues are mentioned in your fund's prospectus, but you may not know that your fund can be volatile until your fund's semi-annual report. The use of leverage by mutual funds can significantly increase a fund's volatility, so low-risk investors may want to avoid funds that trade derivatives.

Included in this topic of the fund-holding securities, what you may not want to own is the issue of style drift. For example, one might invest in a value fund which focuses on large "blue chip" companies selling at modest price-earnings ratios. But the fund manager may get tempted by the fast increase in Internet stocks and start allocating the

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<sup>4</sup> "Taxes are one of the most significant costs of investing in mutual funds through taxable accounts... Recent estimates suggest that more than two and one-half percentage points of the average stock fund's total return is lost each year to taxes." SEC website <http://www.sec.gov/rules/final/33-7941.htm>.

fund's money into these investments. You can avoid this problem of style drift by using funds that can never vary from their stated style in the prospectus.

**Trading Limitations:** Note that unlike a stock, you cannot buy or sell open-end fund shares in the middle of the trading day. While the once-per-day trading limitation may seem fine to you, more active traders desire to trade in the middle of the day and also to sell short to capitalize on market movements. While we will not discuss short-selling in this pamphlet, mutual funds cannot be sold short and there are no puts or calls on mutual fund shares.

**Commingling:** Last, is the potentially negative issue that your money is commingled with the money of other investors. When the market declines, if other investors in the mutual fund get nervous and take their money out of the fund, this forces the fund manager to sell securities in the fund. The sale is necessary to get the cash to send to the fund investors. So while you may view a decline as an opportunity to buy, your fund manager cannot do so as he is forced to sell to meet redemptions of the nervous investors.

To address the disadvantages above, Wall Street created Exchange Traded Funds.

## Exchange Traded Funds (ETFs)

ETFs were developed to mitigate the disadvantages of open-end mutual funds, covered previously.

First, the shares provide diversification just as do open-end mutual funds in that they often track an entire index, such as the S&P 500 index. Therefore, one could argue that this is similar to owning the 500 shares in the S&P index.

Secondly, ETFs' shares are traded on the stock exchange. This means that the shares can be bought or sold at any time during the day like any share of stock. A more active trader finds this flexibility appealing as open-end mutual funds shares can only be bought or sold at the end of the day. Moreover, ETFs' shares can be sold short and many have puts and calls traded on them, thereby enhancing their appeal for an active investor.

Next, more sophisticated investors are typically sensitive about fees. Because many ETFs track an index, the holdings within the ETF rarely change. Because there are few changes, there is no need for an active manager, and as a result, the cost to manage the fund and the fees to the investor are much smaller. As Wikipedia summarizes, "Mutual funds can charge 1% to 3%, or more; index fund expense ratios are generally lower, while ETFs are almost always in the 0.1% to 1% range. Over the long term, these cost differences can compound into a noticeable difference."<sup>5</sup> Do note that to trade ETFs, the investor pays a commission for the transaction.

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<sup>5</sup> [http://en.wikipedia.org/wiki/Exchange-traded\\_fund#Costs](http://en.wikipedia.org/wiki/Exchange-traded_fund#Costs).

Closely related to the previous paragraph is the mentioned low turnover. Because there is very little buying or selling of shares, there is a very small tax impact to the investor. In the illustration of an ETF which tracks the S&P 500 index, all holdings in the ETF are typically held for more than a year, so when a sale does occur, it is a long-term sale resulting in a long-term capital gain or loss. Long-term capital gains are taxed at preferential rates as are qualifying dividends from the shares in the fund.

An ETF, like an open-end mutual fund, has many investors' money commingled. Some investors would like to have their portfolio managed separately and thereby gain ultimate tax control from the timing of purchases and sales. That opportunity is provided by separately managed accounts.

## **Separately Managed Accounts**

Separately managed accounts go by several names in the securities industry such as wrap accounts, individually managed accounts, fee-based accounts, managed accounts – and they were originally an offering available to the wealthiest of investors – typically having \$1 million or more in a portfolio. However, investment managers and brokerage firms, using technology, have been able to offer separately managed accounts to investors of more modest means. Let's take a look at the advantages.

### **Individual cost basis**

Because each security in the account is your own security and belongs only to you, you know how much it was purchased for, and prior to sale, you know how much the taxable gain will be. This permits you to instruct the manager to avoid taking profits at times when it may be bad for you from an income tax standpoint. If you own shares in a mutual fund, you simply get a 1099 form at the end of the year outlining how much you have to report to the IRS. Surprise!

Because you have an individual cost basis in each security, not only can you manage the gains and losses within that portfolio, you can manage your overall tax situation. Let's assume you sold a piece of real estate and have a profit. You may ask your separate account manager to sell some stocks with losses before the end of the year ; thereby recognizing those paper losses to save you tax dollars.

To take the tax issue a step further, you may not have realized that when you buy a mutual fund, there may be embedded capital gains. This means that the fund has already made sales, captured profits, and at the end of the year – even though you are a new shareholder – you will be forced to pay your share of the tax on the gains that occurred prior to you becoming a shareholder. With a separately managed account, you never have this embedded capital gains issue.

### **Personalization**

If you have specific social convictions, such as the avoidance of tobacco stocks, you can provide that instruction to your separate account manager. Unlike a commingled account, your wishes within reason can be reflected in your investment account.

Because separately managed accounts can be offered for as little as \$100,000, for your \$300,000, you could have three different professional managers. Each manager could focus on a separate financial goal you have, a goal that matches the selected manager's expertise.

### **Transparency**

Separate accounts provide you with comprehensive performance reporting and full disclosure of all costs. Unlike a mutual fund that does not tell you how much you profited or lost for the year or what the fund holds at any time, you will receive a quarterly report that shows your gain or loss clearly with all costs clearly indicated. Because most separately managed accounts are available to view on-line, you can check on your holdings 24 hours a day.

### **Fees**

Mutual funds often charge sales loads, management fees and service fees while separately managed accounts typically charge an all-inclusive “wrap” fee.<sup>6</sup>

### **Discipline**

Possibly the most valuable feature of a separate account manager is their investment discipline. These managers typically have an investment model that tells them what to buy and sell and when to buy and sell it. They do not react to every news story as some individual investors do. It's this discipline that many wealthy investors feel separate them from those who have not been as financially successful.

### **Caution**

Some separately managed accounts invest in mutual funds or other registered investment companies and may thereby subject the investor to 2 sets of fees – the advisory fee for the separately managed account itself plus the management fees and expenses of the underlying registered investment companies.

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<sup>6</sup> MFS Investment Management, “Is a Separately Managed Account for You?” *December 2013*  
<https://www.mfs.com/wps/portal/mfs/us-investor/products/separately-managed-accounts>

Comparing the Features			
	Mutual Funds	ETFs	Separately managed account
<b>Investment Objectives</b>	Fund owner typically desires passive involvement. Investor objectives can be income, growth or any combination thereof	Fund owner typically desires passive involvement - may desire sector focus as ETFs are available with niche security holdings, equity, growth, combination, speculation, inverse or leveraged performance and shorting	Investor desires higher degree of personalized service with objective of income, growth or combination thereof
<b>Costs</b>	Available in load and no load varieties. Load varieties may contain front end or back end fees and/or continuous marketing fees as well as management fees	Each transaction to buy and sell ETF shares incurs a commission	Usually no start up or redemption costs
<b>Expenses</b>	Actively managed mutual fund investors pay an average of 3.01% in annual fees <sup>1</sup>	Operating expenses are lower than mutual funds <sup>2</sup>	Typically a wrap fee of 1% to 3% annually
<b>Ownership</b>	Investor owns shares in a pool of securities, commingled with assets of other investors	Investor owns shares in a pool of securities, commingled with assets of other investors	Investor owns individual securities
<b>Portfolio holdings</b>	Identical for all investors	Identical for all investors	Based on a stated investment discipline but may be customized to a limited extent (usually by excluding specific holdings)
<b>Liquidity</b>	Purchase or sell shares to/from the fund any day	Purchase or sell shares to another investor during market hours	Securities in portfolio can be sold during market hours
<b>Minimum investment</b>	Typically ranges from \$500 to \$2,000 per fund	Typically ranges from \$500 to \$2,000 per fund	Typically \$100,000 per account
<b>Tax basis</b>	May include embedded capital gains going back months or years before investor bought shares - investors pays capital	Basis is original price paid. Capital gains/loss tax on an ETF is incurred only upon the sale of the ETF by the investor	Basis is original price paid for each security. Capital gains/loss tax on an individual securities is incurred only upon the sale in the account

	gains tax on his share of the fund each year		
<b>Tax management</b>	Under sole control of portfolio manager	Potential for client and his or her financial advisor to manage taxation of gains by timing sales. Potential for unqualified dividends taxed at higher rates.	Potential for client and his or her financial advisor to manage taxation of gains
<b>Safety and Guarantees</b>	Will fluctuate with the market. Some funds may offer principal guarantees for extra cost.	Will fluctuate with the market- may incur loss.	Will fluctuate with the market - may incur loss.
Data in above table from MFS Investment Management, "Is a Separately Managed Account for You?" <i>December 2013</i> <a href="https://www.mfs.com/wps/portal/mfs/us-investor/products/separately-managed-accounts">https://www.mfs.com/wps/portal/mfs/us-investor/products/separately-managed-accounts</a>			

1 Wealthfront website <https://www.wealthfront.com/research/mutual-fund-fees>

2 Table below from Forbes <http://www.forbes.com/sites/feeonlyplanner/2013/07/18/whats-the-difference-mutual-funds-and-exchange-traded-funds-explained/>

	<b>Average Total Operating Expenses</b>	
<b>Fund Type</b>	<b>Mutual Funds</b>	<b>ETFs</b>
US Large-Cap Stock	1.31%	0.47%
US Mid-Cap Stock	1.45%	0.56%
US Small-Cap Stock	1.53%	0.52%
<u>International</u> Stock	1.57%	0.56%
Taxable Bond	1.07%	0.30%
Municipal Bond	1.06%	0.23%

# About

**Phone today with questions or to see if we can help you.  
There is no charge for an initial meeting.**

This booklet is presented solely as educational material about some aspects of Mutual Funds. It is not intended to recommend or dissuade the purchase or sale of any particular Mutual Fund or of Mutual Funds in general. Mutual Funds are sold by prospectus, which contains more complete information including risk factors, fees, surrender charges and other costs. You should obtain a prospectus from your financial representative. Please read the prospectuses carefully before you make a purchase or invest.

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