

# What Every Physician Needs to Know About Mutual Fund Investing

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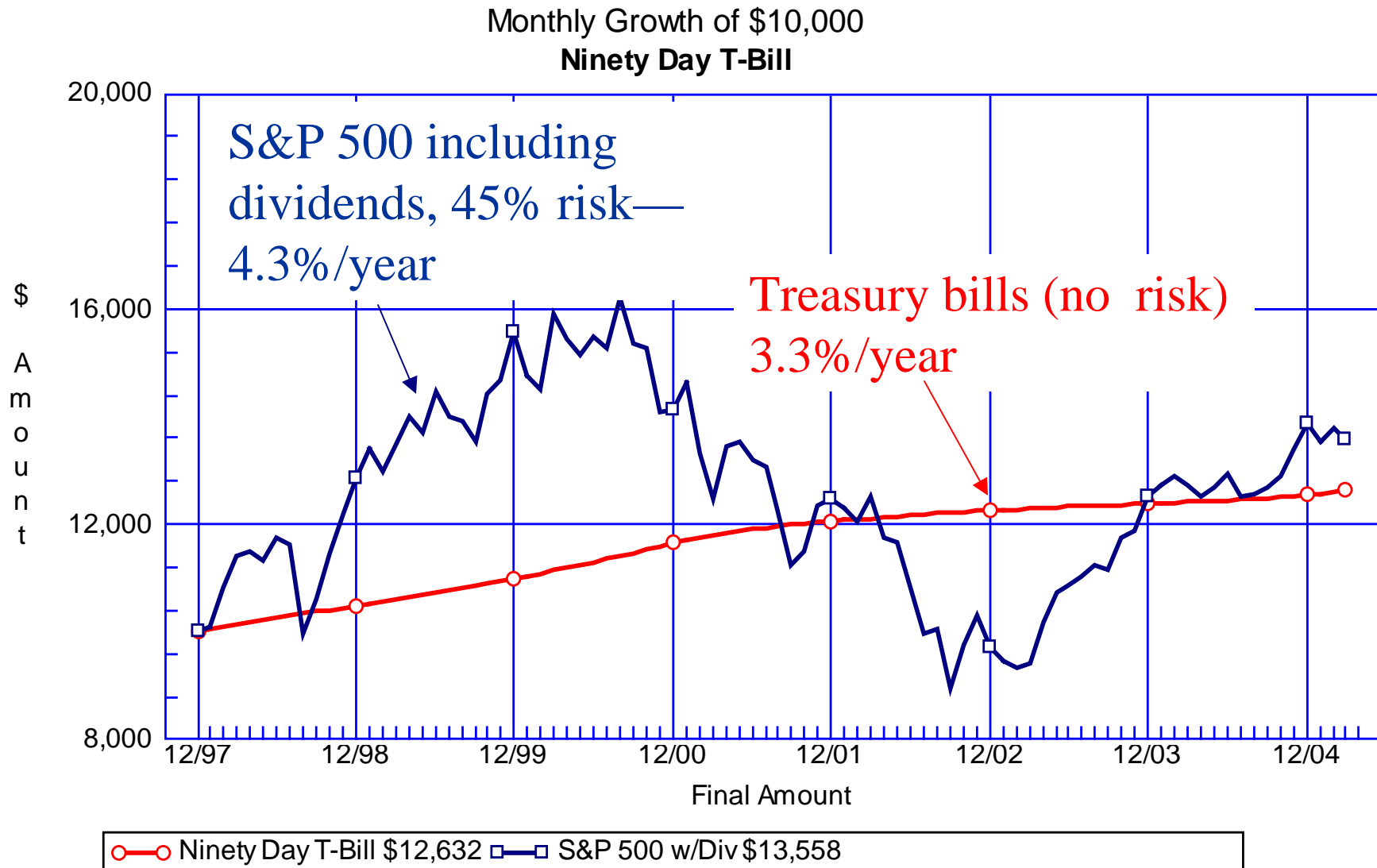
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# Goal-stock market returns with bond-like risk

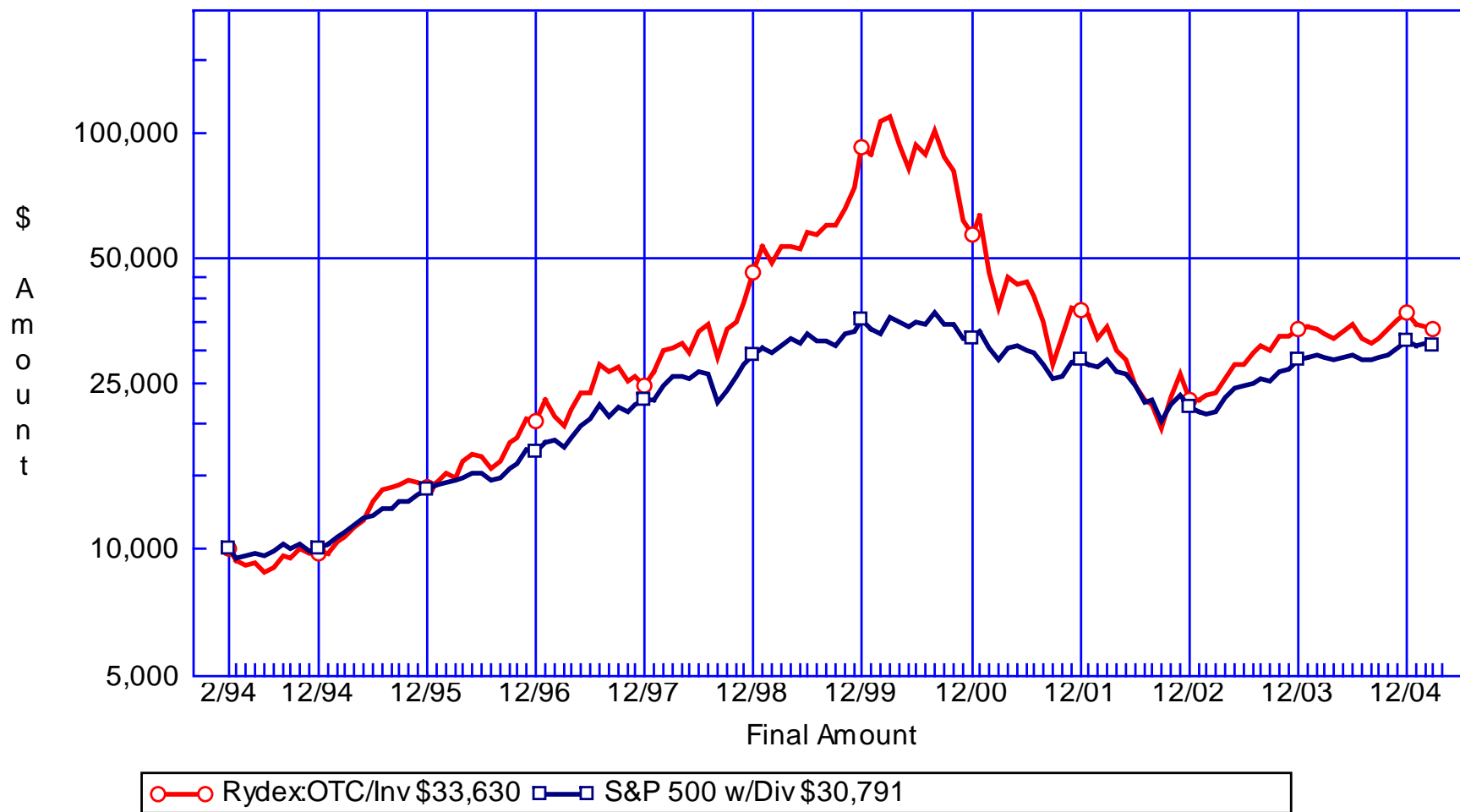
- Investment basics—risk and reward, diversification
- One-decision portfolio--Buy index funds and top-rated small company, bond and real estate funds.
- Why the one-decision portfolio works
- How to pick mutual funds for the long term.
- What not to do: load funds, technology funds.
- Opportunity investing strategies for greater returns
- Buy dividend yield on sale: closed-end funds.

# Balance of risk and return



# Which fund is better?

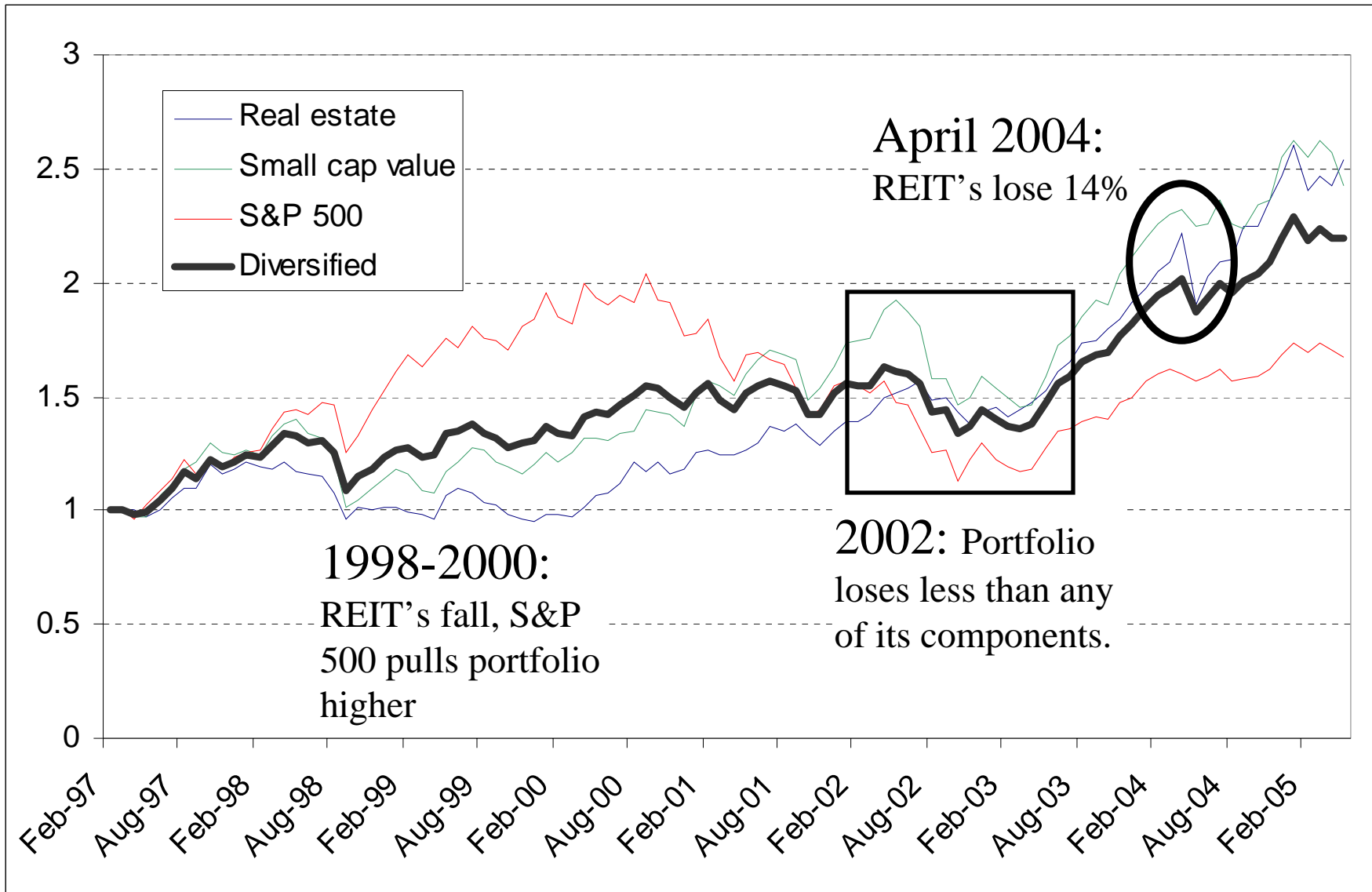
Monthly Growth of \$10,000  
Rydex Srs Tr:OTC Fund/Inv





We were wondering if now would be a good time to panic.

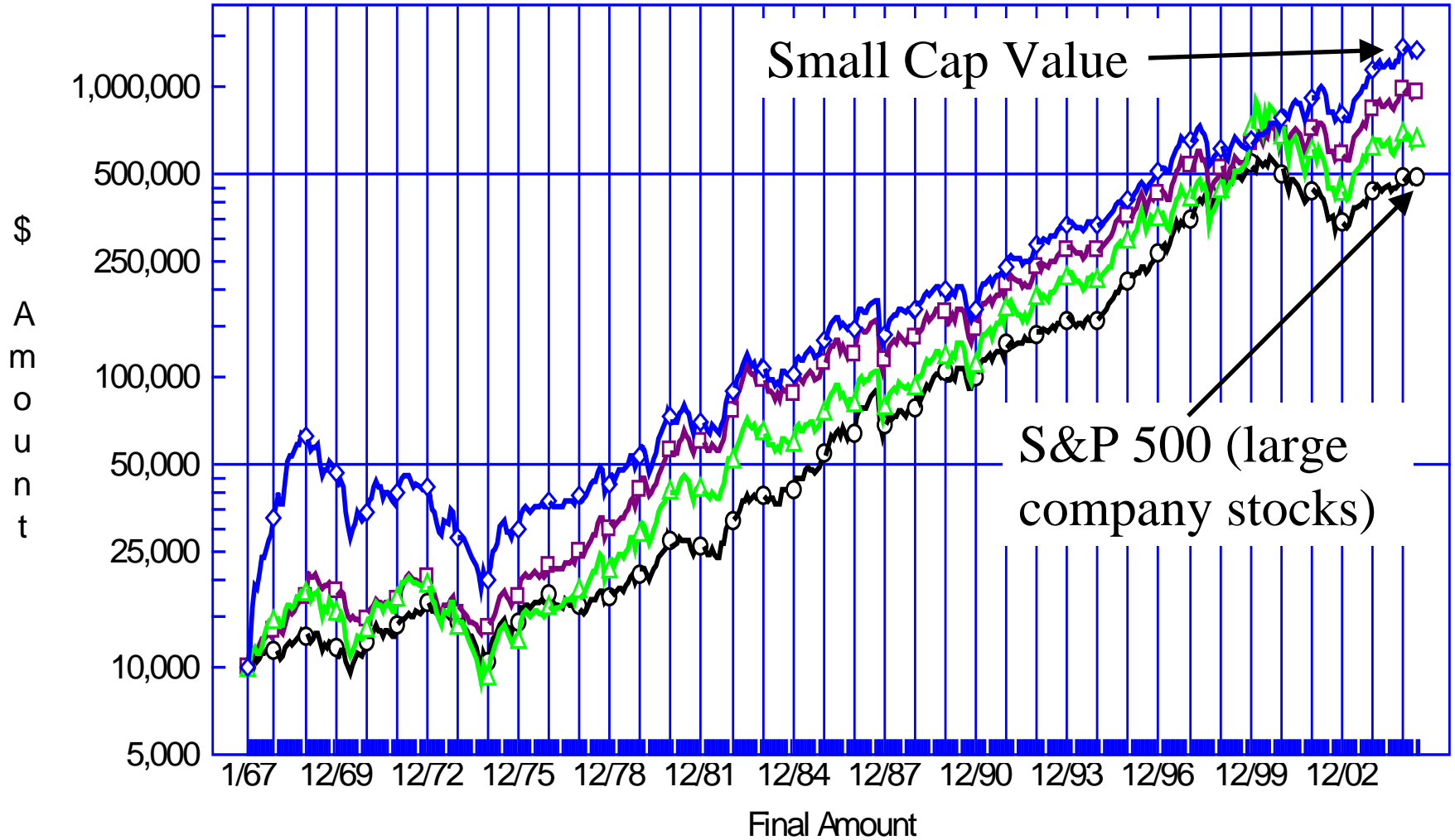
# The benefit of diversification



# Putting it all together—a one-decision portfolio

- 30% short term government bonds
- 20% intermediate term bonds (Lehman Aggregate Index)
- 20% S&P 500 Index Fund (Vanguard)
- 20% Real Estate Investment Trusts
- 10% Small Company Value (Russell 2000 Value Index)

Monthly Growth of \$10,000  
**S&P Composite of 500 Stocks with Div**



○—○ S&P 500 w/Div \$487,384	□—□ Small Cap Blend Avg \$965,760
△—△ Small Cap Growth Avg \$669,636	◇—◇ Small Cap Value Avg \$1,342,965

## 25-year Performance (6/80-5/05)

- Return 10.7%/year
- Worst loss from a high value: 11.2%
- Worst loss in a 12-month period: 5.4% (to March, 2003)

On a risk versus reward basis, these results beat every one of the components of the one-decision portfolio.

# One decision portfolio performance compared to its components

6/1985-5/2005	<b>One- decision portfolio</b>	Bonds (Lehman Agg.)	Large stocks (S&P 500)	Small value stocks	Real estate stocks	90-day Treasury Bills
Annual gain (%)	<b>10.7</b>	9.4	13.0	15.2	13.0	6.0
Worst 12 months (%)	<b>-5.4</b>	-5.1	-27	-28	-20	+1
Worst loss (%)	<b>-11</b>	-9	-45	-33	-22	0

Source: Mutual Fund Expert database, 5/31/2005

One-decision portfolio recap—  
This portfolio has minimized the  
likelihood of a losing year

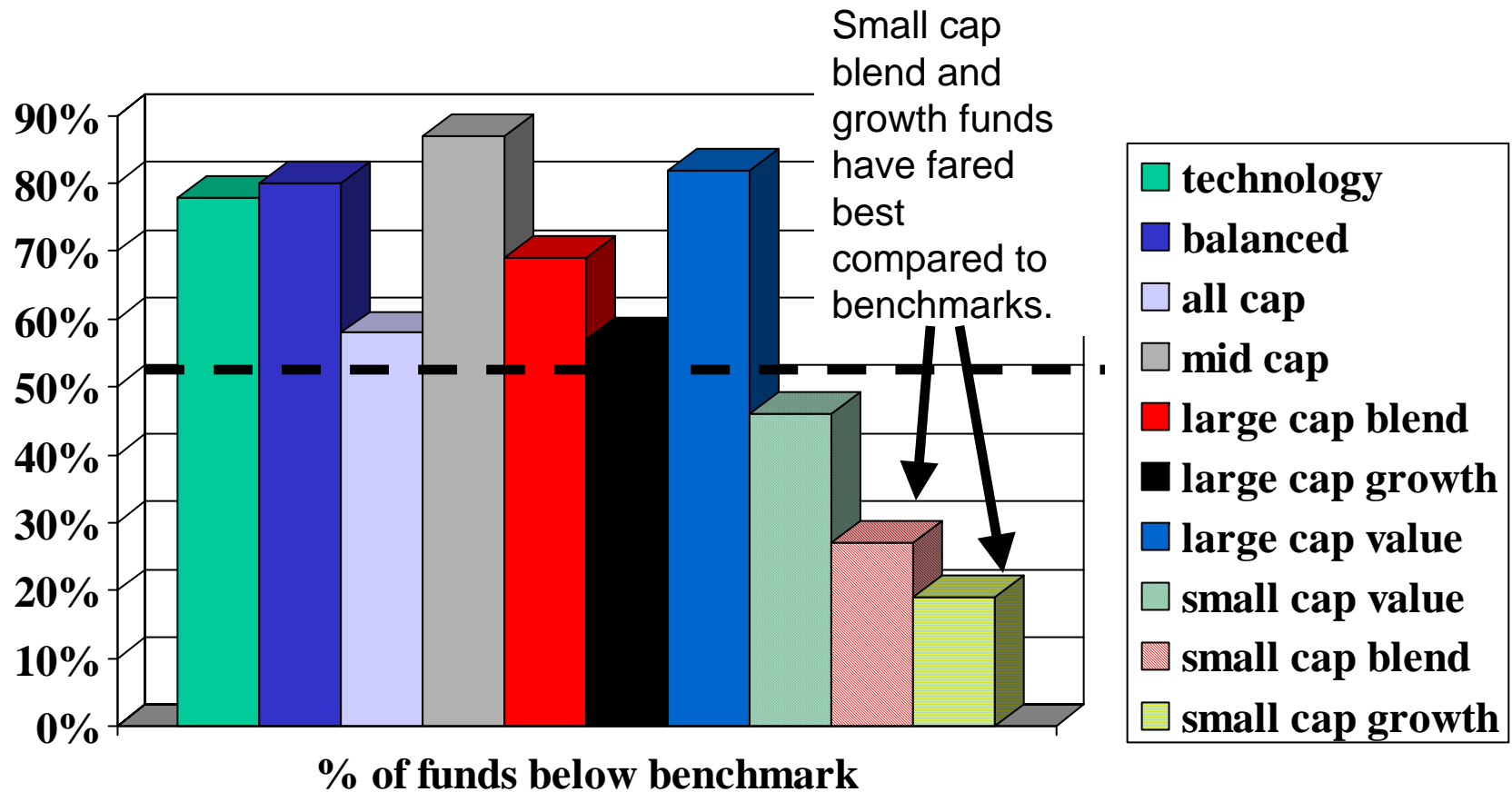
- 30% short term government bonds
- 20% intermediate term bonds
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- 10% Small Company Value

# How to pick the best mutual funds for your long term portfolio: index funds versus active management

- Small company versus large company

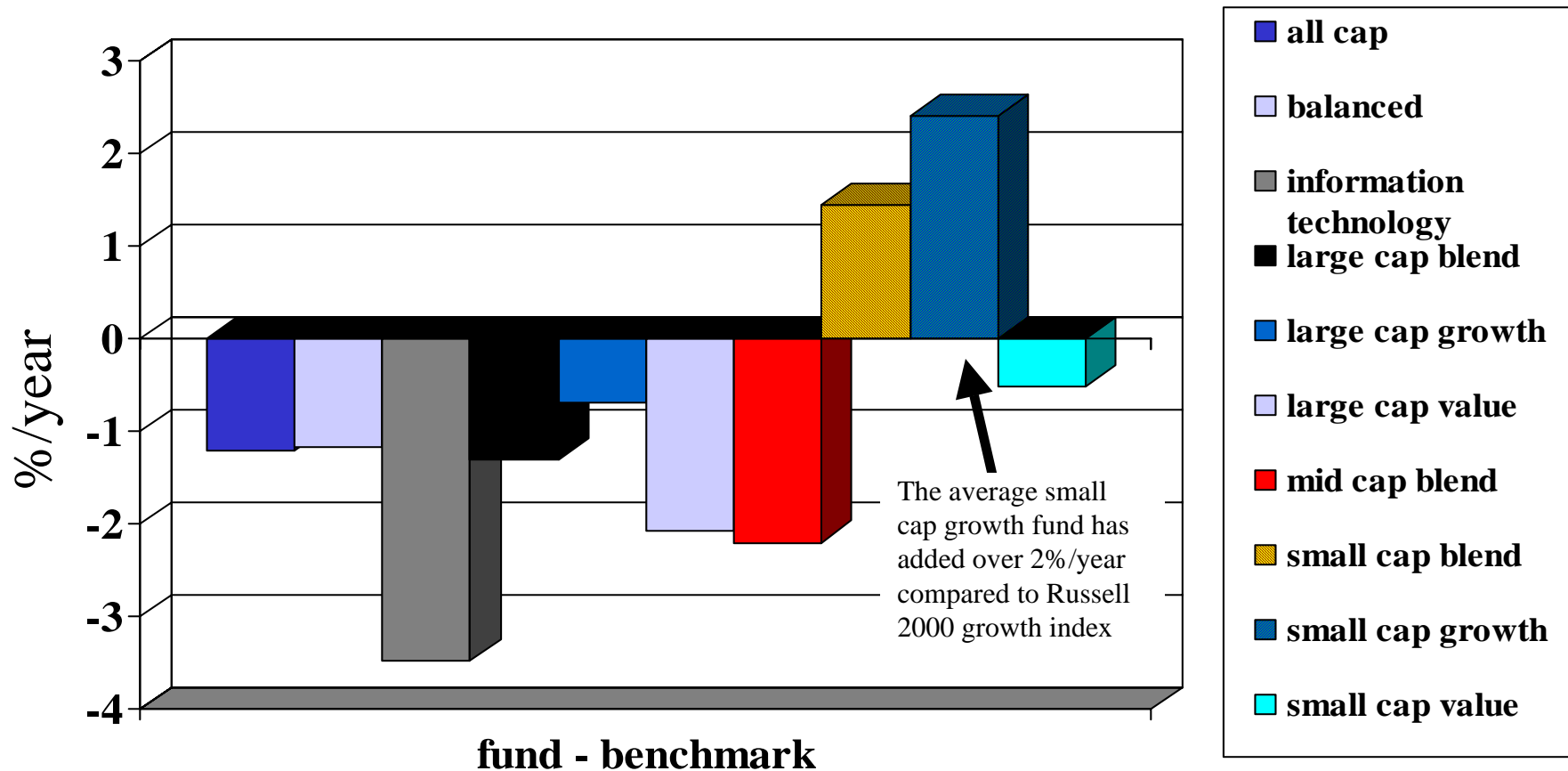
Each of these has different historical behavior patterns and so may require different strategies.

# Percent of mutual funds that have lagged their benchmarks over the past ten years (risk-adjusted)



Source: Mutual Fund Expert Database of 8/31/2004, 10-year Sharpe ratios

# Performance of average fund minus benchmark (%/year, adjusted for risk)



Past ten years' data from Mutual Fund Expert, Aug. 31, 2004 edition

# Picking mutual funds

- Index funds: for large company funds.
- Choose actively managed funds: for small company funds.

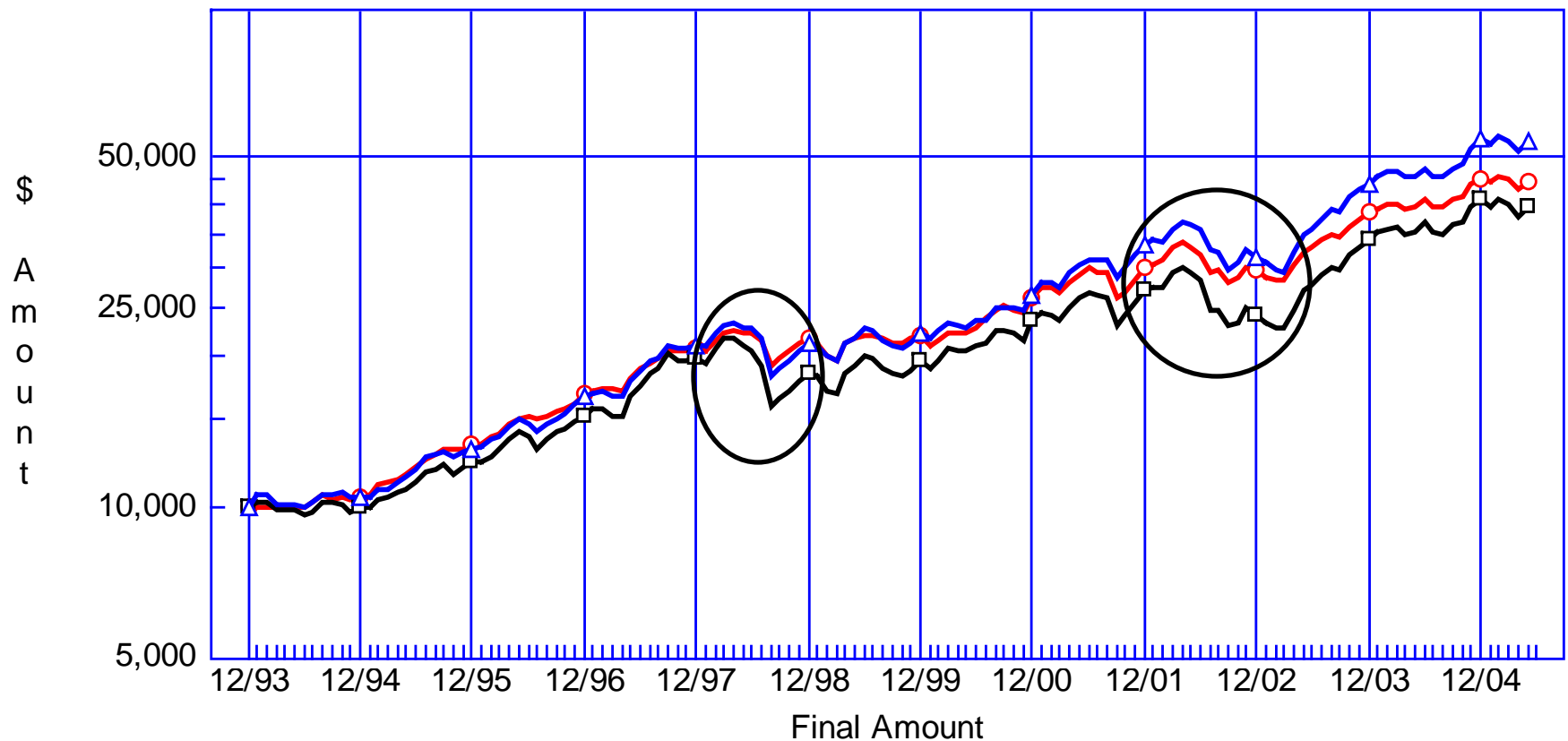
Research has shown that a prior year's outperformance *within* the universe of small company blend and value funds has not been predictive of outperformance during the coming year.

# Long term investment selection criteria: reward and risk

- Below-average losses during prior bear markets.
- Low overall volatility compared to peer funds.
- Good returns relative to past risk through a complete market cycle (advance and decline)
- Past gains (without also considering risk) has not been predictive, but in certain cases past risk-adjusted performance has been.

# Funds with below-average risk in prior bear markets

Monthly Growth of \$10,000  
Royce Fund Total Return/Inv



○ Royce Tot Ret/Inv \$44,738      □ Small Cap Value Avg \$39,939  
△ Fidelity Low Priced Stock \$53,532

# Small cap value index funds (ETF's)

You buy these like stocks (through a discount brokerage account).

- StreetTracks Dow Jones U.S. Small Cap Value Index Fund (DSV)
- iShares S&P 600 Small Cap Value Index Fund (IJS)

# Recommended One-Decision Portfolio

- 20% Vanguard S&P 500 Index Fund (VFINX)
- 20% Fidelity Real Estate Fund (FRESX)
- 10% Royce Total Return Fund (RYTRX)
- 20% Pimco Total Return Fund, Institutional class only (PTTRX)\*
- 30% Vanguard Short Term Investment Grade Bond Fund (VFSTX)

\*PTTRX is available at certain discount brokerages without a sales charge. If you do not have access to Pimco Total Return without a sales charge, consider no-load Dodge & Cox Income (DODIX),

# One-decision low-cost portfolio at Vanguard

- 20% Vanguard S&P 500 Index Fund (VFINX)
- 20% Vanguard Real Estate Investors Trust Index Fund (VGSIX)
- 10% Vanguard Small Cap Value Index Fund (NAESX)
- 20% Vanguard Intermediate Term Investment Grade Bond Fund (VFICX)
- 30% Vanguard Short Term Investment Grade Bond Fund (VFSTX)

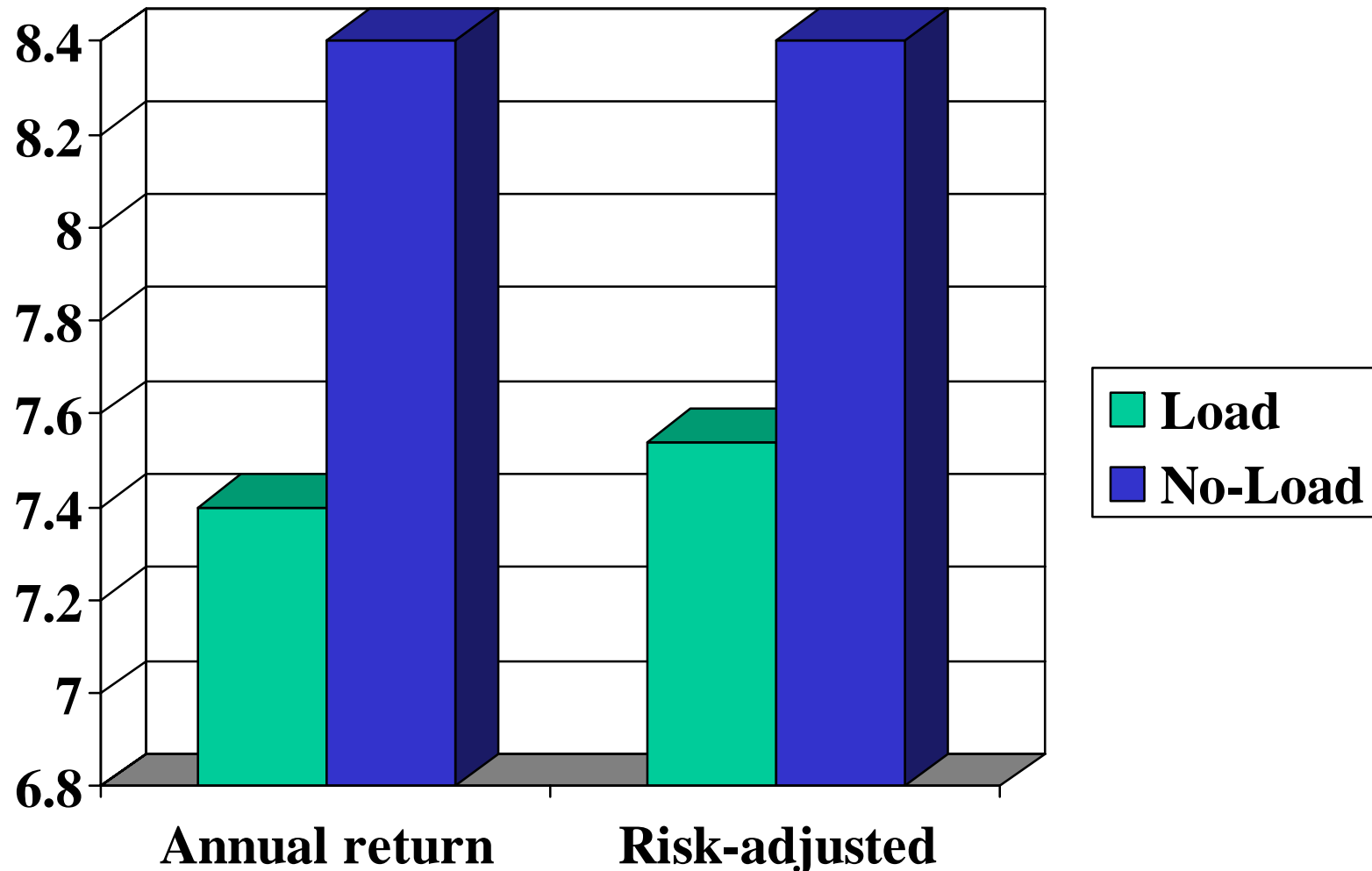
# Recap—Long term fund selection strategy

- Buy low-cost index funds or exchange-traded funds for all styles except small company stocks.
- Recommended small cap value funds: Royce Total Return, iShares S&P 600 Value Index Fund, StreetTracks Dow Jones U.S. Small Cap Value Index Fund (also Fidelity Low Priced Stock and Aegis Value when available)

# Two quick pearls

- Do not pay a sales load or a back-end load (without a very good reason).
- Do not buy and hold technology funds.

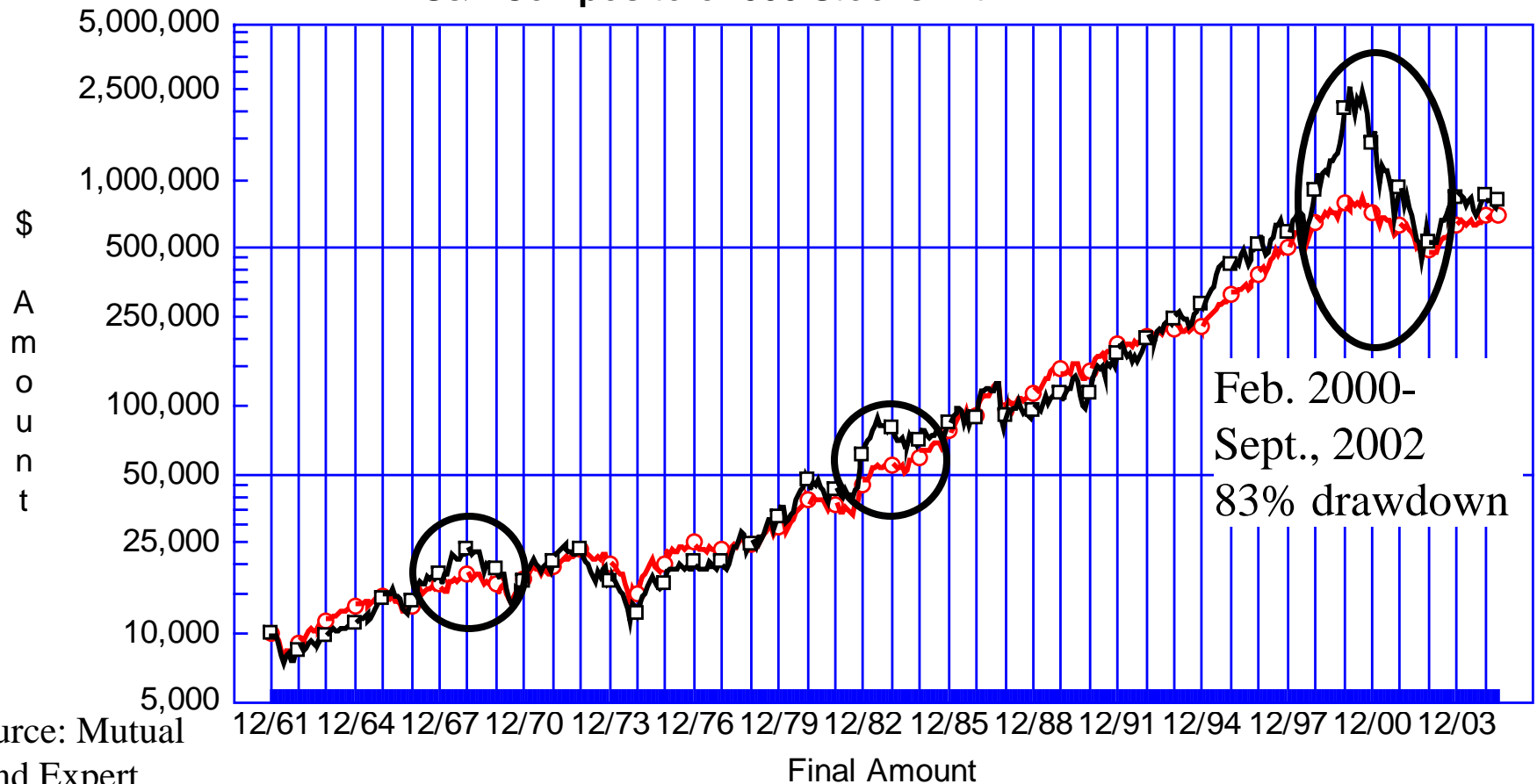
# Choose No-load Funds



1994-2004 annual performance data, 549 load and 746 no-load equity funds with histories back to 1994. Duplicate load share classes eliminated, lowest expense-ratio share class used, sales load not incorporated into returns. Source: Mutual Fund Expert database, 8/31/2004.

# Tech funds have always fallen back down to Earth.—Do not buy and hold them.

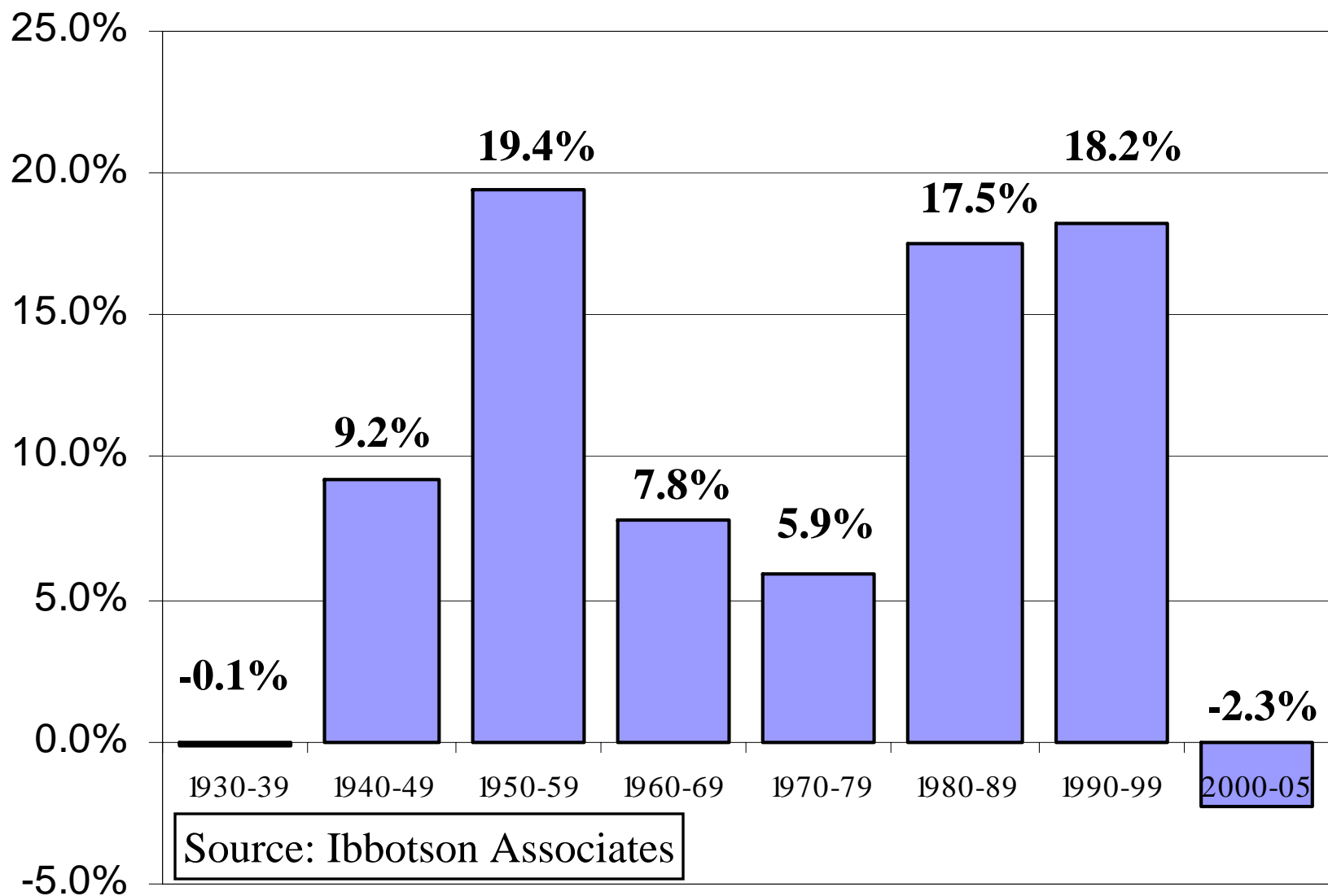
Monthly Growth of \$10,000  
S&P Composite of 500 Stocks with Div



Source: Mutual  
Fund Expert  
Database,  
5/31/2005

○—○ S&P 500 w/Div \$695,808      □—□ Inform. Technology Avg \$813,334

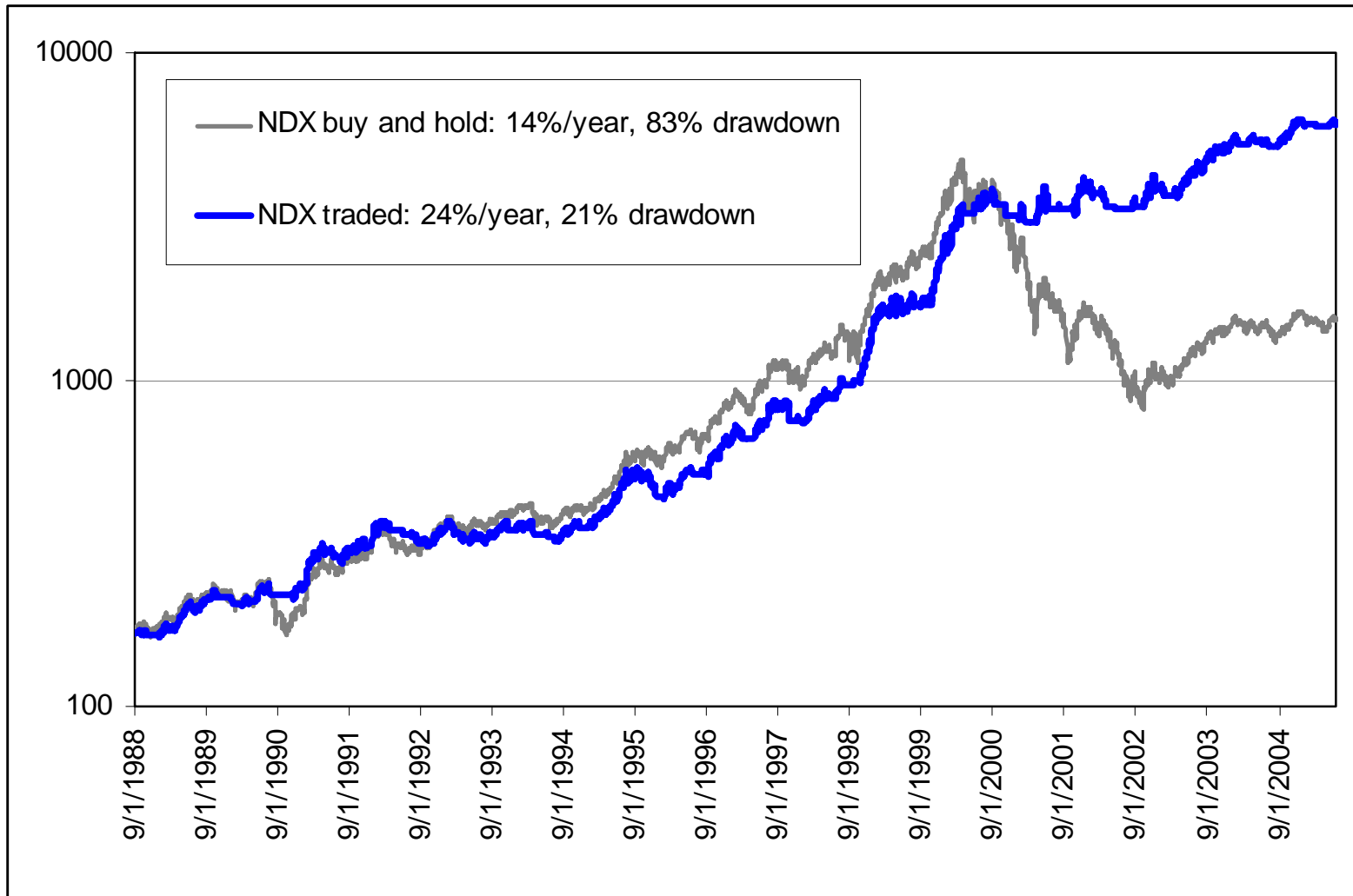
**Average Annual Total Return for Large Company Stocks**  
**during last 8 Decades (Jan 1, 1930 - May 31, 2005)**

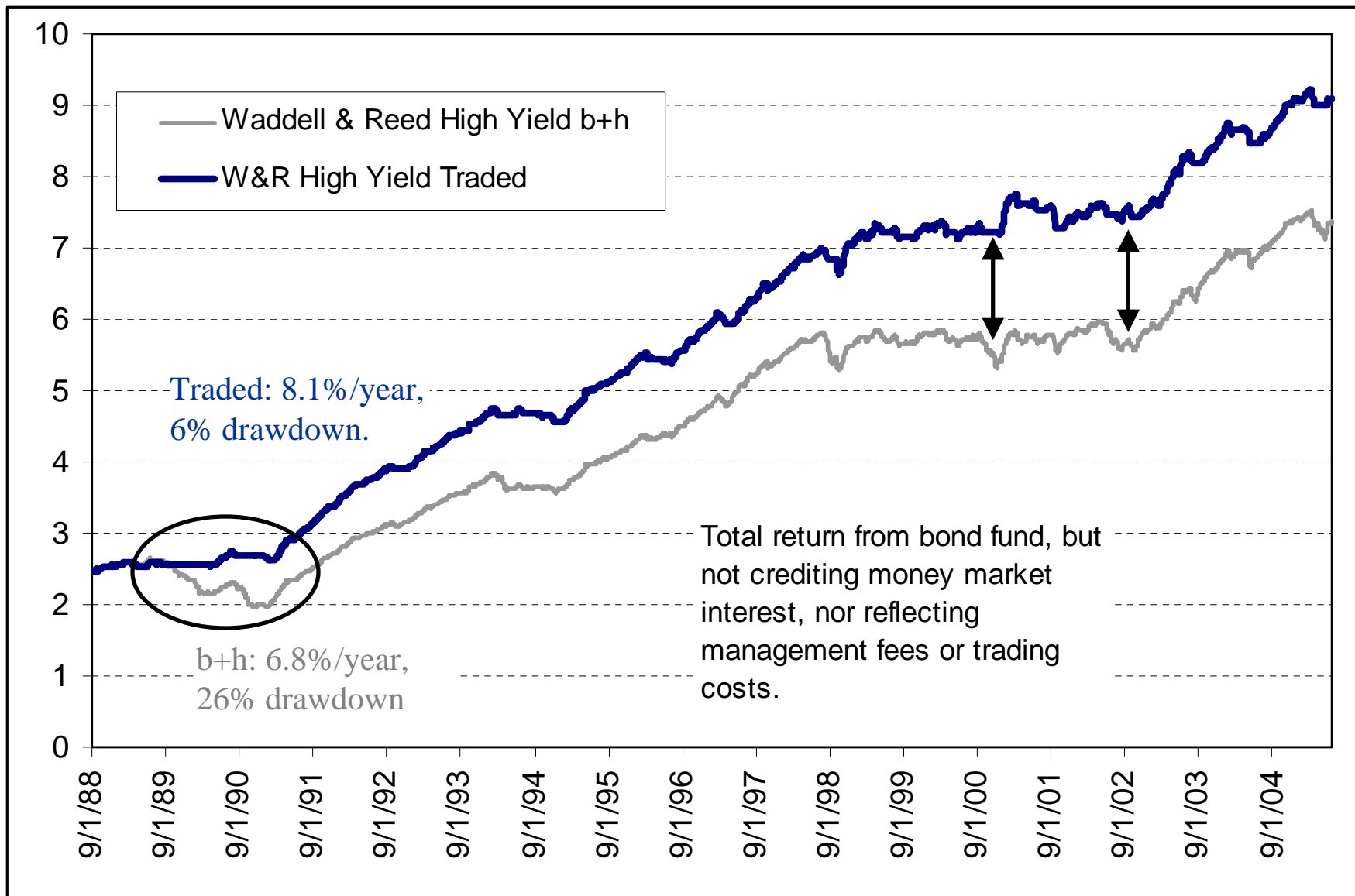


# Opportunity investing—Selecting mutual funds based on past performance.\*

\*Past performance does not guarantee future results, but used properly, performance histories have offered valuable guidance.

# How to handle technology funds—cut your losses.





Hypothetical data from a trading model used in real time since 2003.

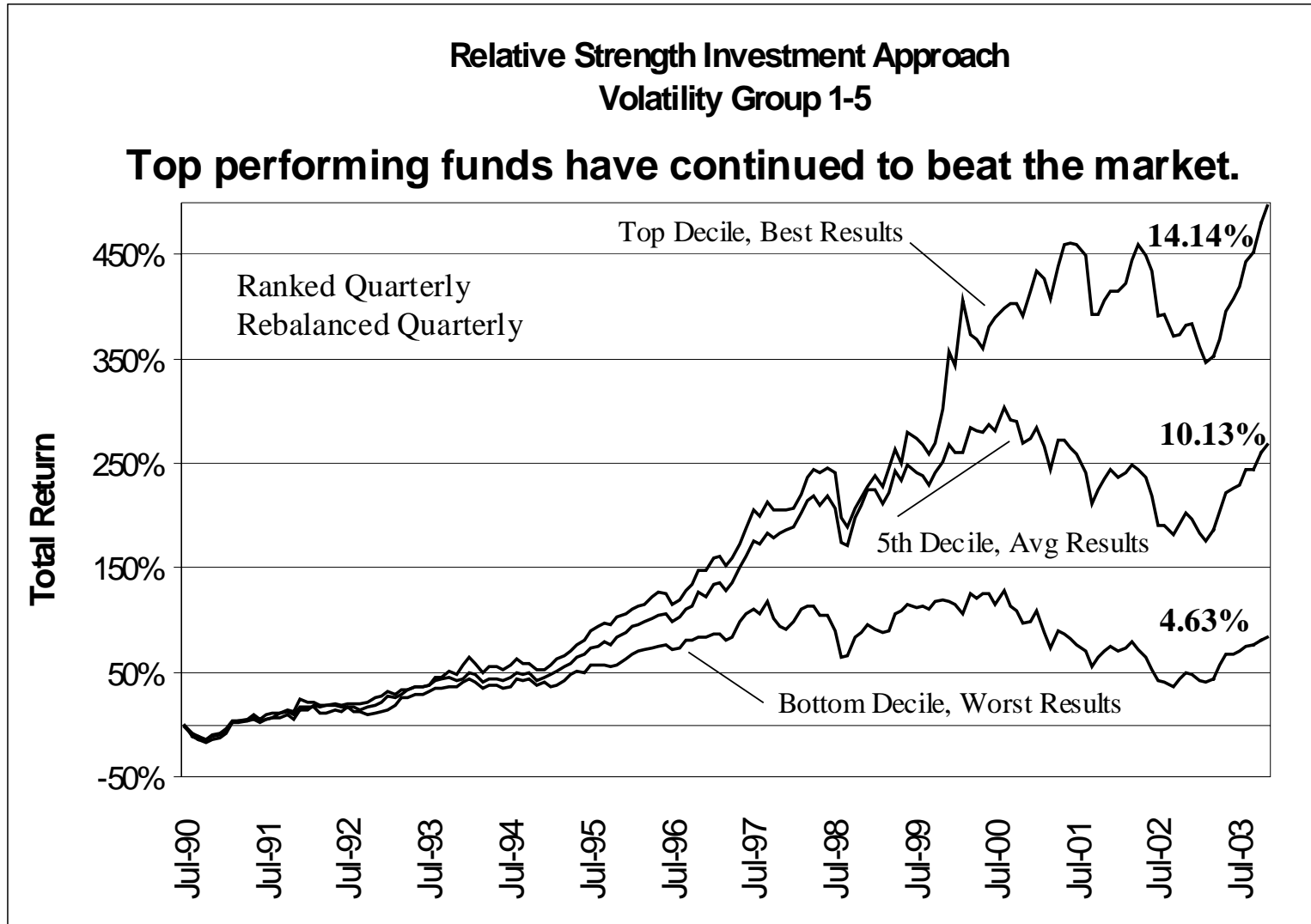
# Mutual Fund Selection Strategy

1. Secure a data base of mutual funds that are equal to or less than the Standard & Poor's 500 Index in volatility. Low volatility funds are safest for this strategy.
2. Rank the funds in your universe by the strength of their performance. We use a more complicated mix of time frames but you should do well enough if you just rank by the performance of funds on a quarterly basis.
3. Purchase a selection of no-load funds from among the top decile, the top 10% in performance within this low volatility universe. Do not place all your capital in just one fund. Three to five is probably sufficient diversification.

Every three months, re-rank your universe. As funds drop out of the top 10% in performance, sell them and use the capital to purchase funds that remain in the top 10% of performers.

**IF YOU FOLLOW THIS PROCEDURE YOUR PORTFOLIO WILL ALMOST AUTOMATICALLY HOLD A HIGH PREPONDERANCE OF SUPERIOR MUTUAL FUNDS.**

# Performance of Rotations

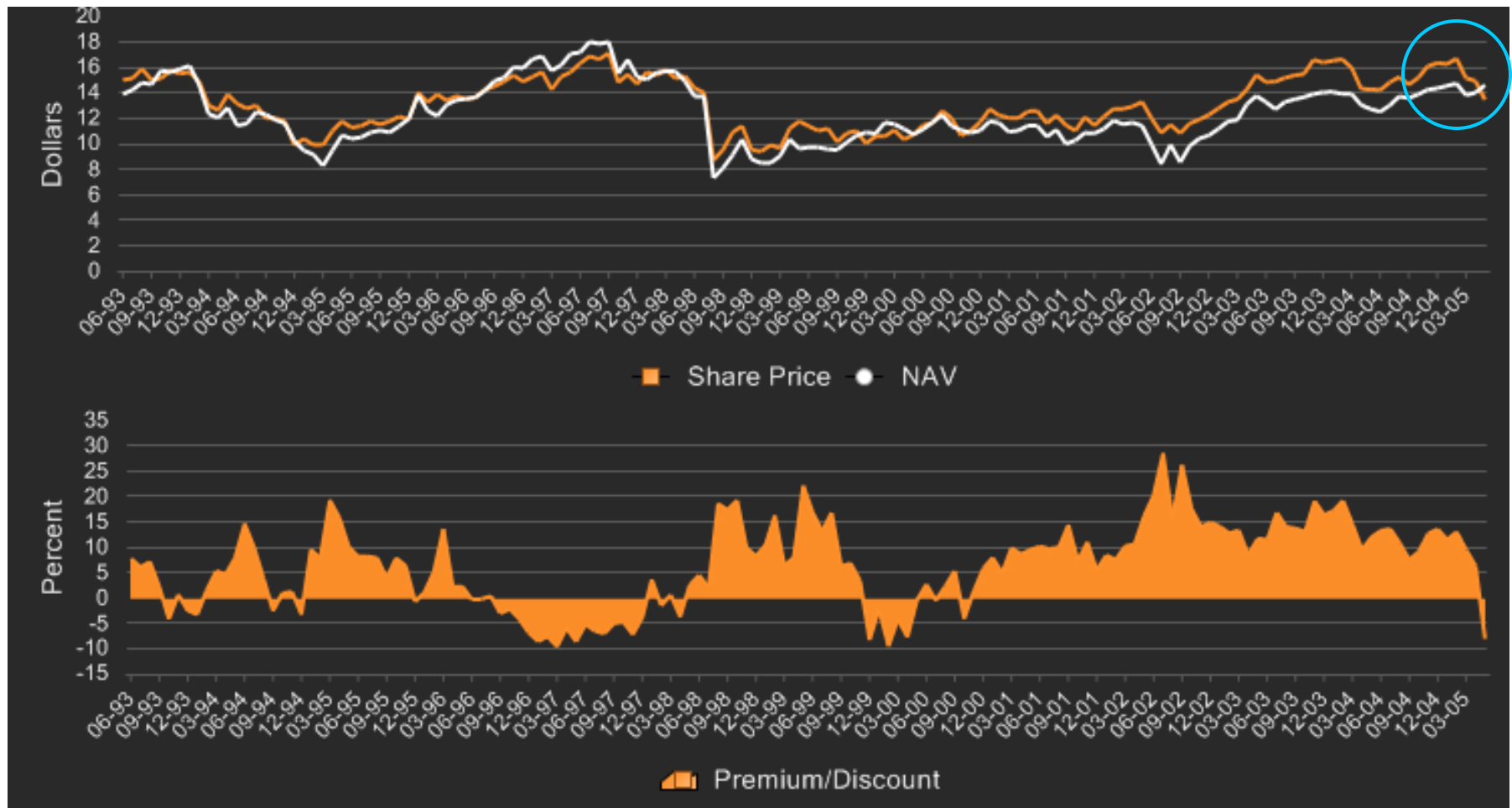


S&P 500 Index including dividends: 11.1%/year during same period.

# Bargain hunting for dividend yield

- Closed-end mutual funds sometimes trade at less than the underlying securities are worth.
- As a result, it has been possible to buy and collect the interest or dividends from \$1.00 worth of bonds or stocks by paying as little as \$0.90 or less.

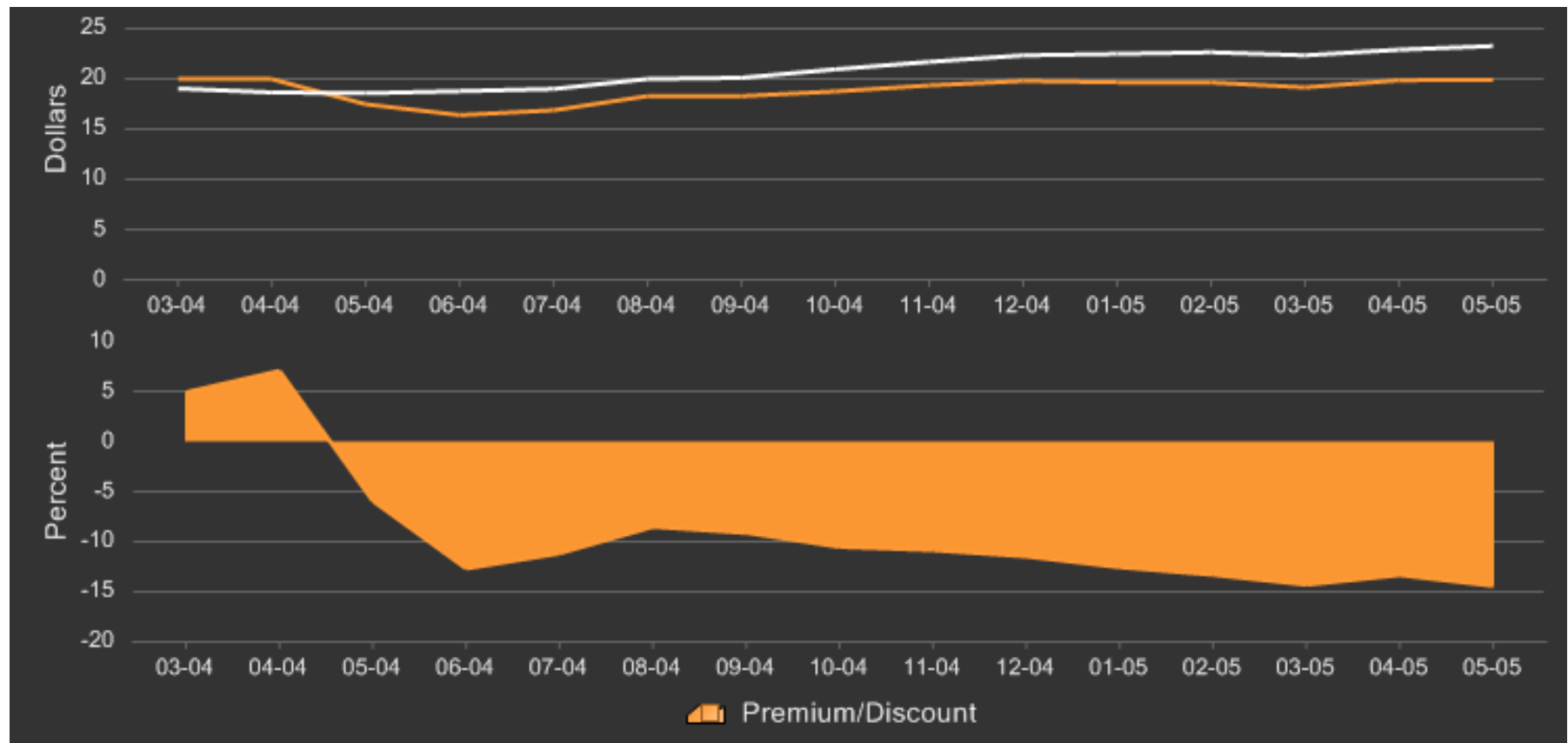
# Example: Solomon Bros. Emerging Markets Income Fund II (EDF): yield 9%, discount 6.9%



The speaker and/or his firm's clients have positions in this fund. Source: ETF Connect.com

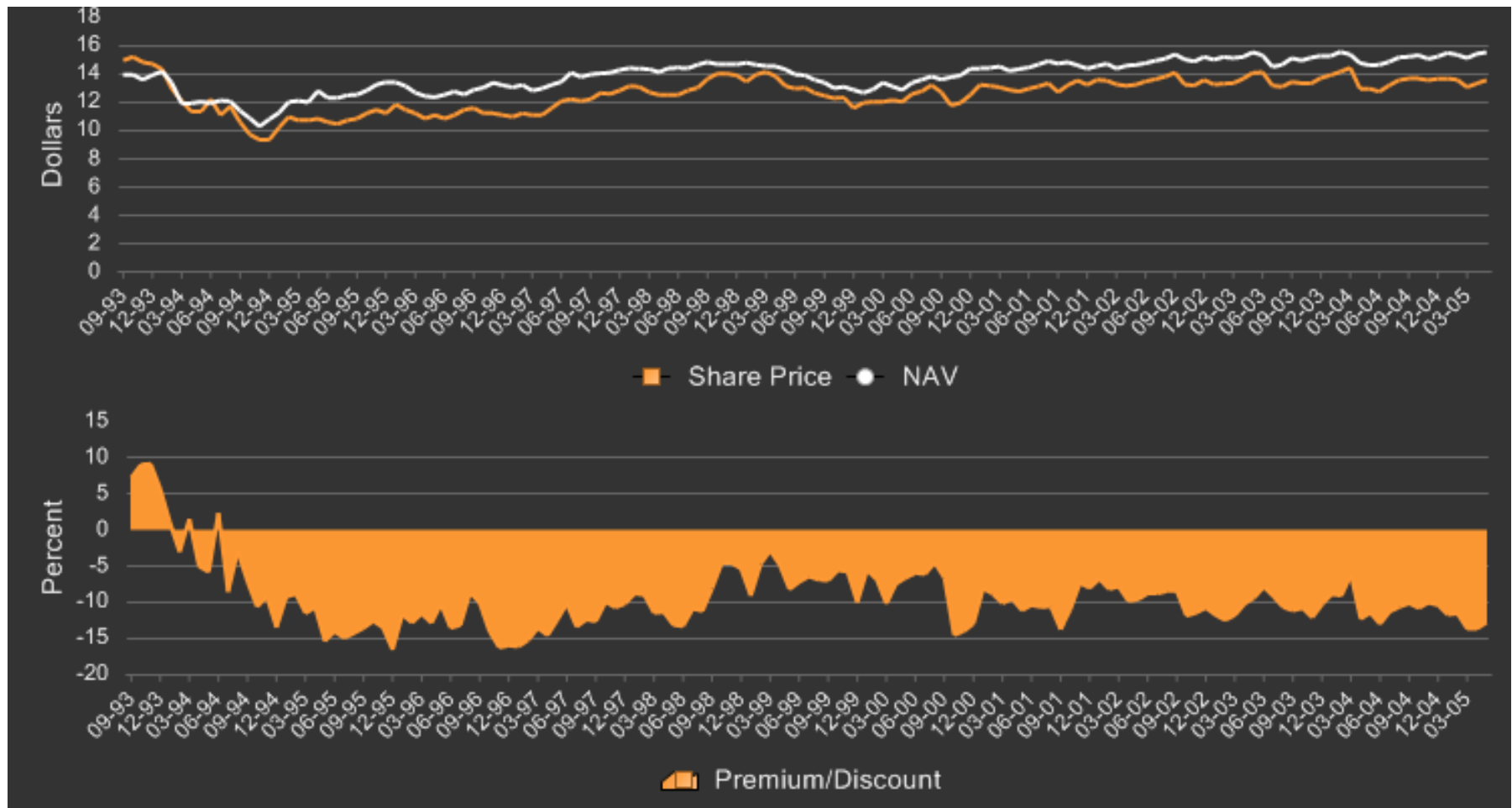
## Example: Cohen and Steers Select Utility Fund (UTF): yield 5.8%, discount 13.5%

Since inception: share NAV +25% but share price only +3.2% because discount widened so much.



The speaker and/or his firm's clients have positions in this fund. Source: ETF Connect.com

# Example: Morgan Stanley NY Quality Municipal Securities (IQN): 5.5% yield (tax-free), 12.5% discount



The speaker and/or his firm's clients have positions in this fund. Source: ETF Connect.com



We study, we plan, we research. And yet, somehow, money still remains more of an art than a science.

# Appel Asset Management Corp.

- Managed accounts (minimum \$50,000) for stock and bond investors using active strategies, including many similar to what I have described here.
- Systems and Forecasts—an investment newsletter containing the latest mutual fund recommendations based on fund risk and performance, as well as market and economic commentary. Free 3-month trial available—turn in the card to me during the rest of the conference or visit our website at [www.systemsandforecasts.com](http://www.systemsandforecasts.com).