FINANCIAL IN$IGHT

COMMITTED TO YOUR FINANCIAL INDEPENDENCE

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Looking For Quality Equity Mutual Funds

In the last few issues we have spent a lot of time discussing stock selection. However, for many of our readers, equity mutual funds are the most appropriate method of holding stocks. Actually, even for those who choose to buy stocks themselves, equity mutual funds often still play a role. They allow them to invest in areas that would otherwise be difficult to manage. Some examples of this are International funds, special region funds, specialty funds and even small cap funds.

Regardless of which category you fall into, selecting quality is as important as if you were buying the shares yourself. In theory, this is why you are paying the fund managers. Nevertheless, if you do not do some careful evaluating of the fund's management, you may wind up being disappointed and discover that you were taking bigger risks than you planned on. So the following are some items that you can find in our IFC Fund Watch Reports. These items will help you weed out lower quality funds.

First you should check the funds long term performance. Look for funds that have above average five and ten year performance for their category. These are the ones that are generally the most consistent performers. This is probably the best and most obvious starting point, but do not stop there.

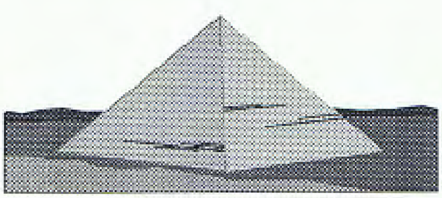
Past performance may mean little if there has been a change in managers. Check the comments section of our Fund Watch Reports to see if the manager has changed recently. When we have information that a manager has changed during the last five years, we indicate it with a N.M. code. While this is a consideration, you may want to discuss any changes with your financial advisor. Some funds are managed using a team approach, or according to a carefully defined philosophy that is not likely to change when one manager leaves.

Look at the fund's volatility. This can be determined by the funds Beta and Standard Deviation. The Beta compares the investments in the fund with a market index, while the standard deviation measures how much the fund's return fluctuates. A Beta of less than one indicates that on average the investments in the fund are less volatile than the market index. Therefore the lower the beta, the lower the risk should be. A low standard deviation indicates that the fund as a whole is a steady performer. Of course funds with lower beta's and standard deviation's may also be expected to be poorer performers, as they are usually more conservative.

Now check the fund's risk adjusted R.O.I. This is a return adjusted by the fund's beta as compared to the market index. A positive number indicates that after adjusting for the level of risk, the fund outperformed the market on a five year basis. A negative return means that the fund under performed the market. Look for positive values under the risk adjusted R.O.I., but beware of exception values. While it is possible to outperform the market on a regular basis, beating it by an unusually high amount may indicate that everything is not as it seems. We will not recommend that you avoid a fund simply because of this, but we do think that it should raise a flag.

Check the funds expected turnover. This tells you how often the manager expects to turn over (trade) the investments in the portfolio. A high turnover indicates that the manager expects to hold each security less than one year, a medium indicates they expect to hold each investment between one and three years and a low means they expect to hold each investment for three or more years. In our opinion, if they are holding quality and planning for the long term, they would expect to hold the average investment for over three years. Therefore, a low turnover would be an indicator of a higher quality portfolio.

Good Returns Are Important



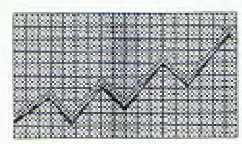
But sustainable returns require quality investments with solid foundations.

What is the manager's method of choosing stocks? In the comments section, we indicate the manager's management style. This may not indicate the quality of the securities in the portfolio, but it does tell you something about their style. Sector rotators (Se) and Top down (T) investors are more likely to try to time the market. Try to match the style with one that you are comfortable with, or hold funds representing a mix of styles. We prefer Bottom up (B) managers that look for either Value (V) or Growth (G) stocks, but then this is because it is the approach we use ourselves.

Finally look at the funds best year and worst year. Doing this has two benefits. First it helps to prepare you for the inevitable, because sooner or later the worst year will be repeated, only it is bound to be worse. Second, it can raise a flag. If the best year is very high, or the worst year is very poor, for the fund's category, it may be an indication that the returns are not very consistent. In this case, ask your broker for a record of the fund's year by year performance for at least the last ten years. Then review these to see how consistent the returns are. Actually, this is probably a good thing to do with any fund before you invest.

The above are not the only indicators, and they will not guarantee anything, but these steps will help you weed out a lot of questionable funds. Hopefully, not so many that there are none left to choose from.

IFC Investment Principles



1 Balance your investments according to your personal circumstances.
2 Always diversify your investments.
3 Invest in Quality.
4 Invest regularly & gradually.