

# Mutual Fund Prospector



Special Report 2002

## Don't Buy, Hold and Hope

**T**hank you for requesting the Prospector's guide to successful mutual fund investing. The information contained in this booklet describes the Prospector's mutual fund investment strategy. This strategy is easy to follow and can provide investors solid, long-term results.

### INVESTOR DILEMMA

I believe many investors want to improve their investment returns without taking significant risks, yet they aren't sure where to turn for advice. Everyday there are more investment opportunities to choose from and investors are overwhelmed with choices and sources of information.

The results of a recent study reinforce the dilemma of the average investor. The study showed the average equity investor earned 7% annually from 1984 through 1997 – one of the best investment eras of this century. During this same period the Standard and Poor's 500 stock index returned 17%! The average mutual fund manager didn't perform much better as index funds outperformed 83% of the available mutual funds during this same period. So how can an average investor expect to improve his returns?

### STRATEGY OVERVIEW

A thorough review of financial literature and academic studies lead the Prospector to two investment concepts that, when combined, offer investors the opportunity to outperform the market averages over the long term. These two concepts are not new, but the combination may be, as the Prospector has not seen this specific strategy in his review of financial literature. The concepts combine index funds and style timing of actively managed funds in one portfolio.

The dual-pronged strategy combines a core position of broad-based index funds with better performing actively managed funds, providing investors benefits that can't be realized by using only index funds or actively managed funds. Here are the concepts of the strategy.

Broad-based index funds offer superior diversification across market segments and managerial styles. Coupled with low expenses and tax efficiency, index funds are a great core holding for an investor's portfolio. These funds track the

market's movement and virtually assure the investor of obtaining "market returns" with this portion of his portfolio. The benefit of index funds is virtually indisputable, as they consistently outperform most actively managed funds over the long term. Thus, index funds are a key element of the investment strategy.

By including actively managed funds in a portfolio, an investor has the opportunity to outperform and under-perform the market averages. Actively managed funds often outperform the market when a manager's portfolio is in sync with the current favorable market trends.



Better performing funds and market segments often exhibit momentum (continued upward price movement) for extended periods of time. If the actively managed funds in the portfolio are weighted toward the better performing market sectors, the investor can achieve superior market performance.

### STRATEGY OPPORTUNITY

The Prospector's trend following, active managed fund strategy provides the opportunity to outperform the market averages with the actively managed funds while limiting potential under performance by using the index fund strategy.

Considering the study of average investor performance, attaining long term performance relatively close to the market averages would be very beneficial to many investors. When coupled with the opportunity to achieve superior market performance, the strategy is certainly worthy of consideration by interested investors.

This guide contains excerpts and articles from the Mutual Fund Prospector newsletter expanding on these concepts and providing detailed information on successfully implementing this investment strategy. The strategy is embodied in the newsletter and the Prospector's model portfolio follows this successful strategy. The model portfolio is easily replicated in either taxable or retirement accounts.

Invest Successfully,

Eric Dany

# Investment Philosophy – The Basics

**T**he Prospector follows a well-defined, disciplined investment philosophy. There are several guiding principles inherent in the investment strategy. Several of the principles are related to modern portfolio theory. Modern portfolio theory is based on academic studies of the investment process from the 1970's. I employ these principles and firmly believe adhering to these basic investment guidelines will benefit most investors.

## DISCIPLINE

Discussions with many investors over the years leads me to believe many investors lack one important element in successful investing...I firmly believe a great majority of investors would attain higher returns if they simply added a larger dose of discipline to their investment prescription. Unfortunately, many elements of human nature are simply detrimental to successful investing. For example, no one enjoys *losing money* and when an investment heads South, the emotional response of *losing money* often takes control and the investor bails out at a loss. Then the investor waits for a *more opportune* time to re-invest, which he usually mis-judges or perhaps he moves the money into a different investment or he may even change his strategy and repeats the money-losing process.

If the first investment was selected for the right reasons and the investor's overall financial situation didn't change, he would probably be better off to hold on to the first investment and wait for it to recover. Do you see yourself in the example above? If you do, don't feel bad, it's simply human nature. Following the Prospector's well-defined, disciplined investment philosophy can help you avoid these investment pitfalls in the future.

## ASSET ALLOCATION

The second principle is asset allocation -- investors should own a variety of investments, choosing between stocks, bonds and money market investments based on their personal financial situation. Because each investor's situation is different, the Prospector can't suggest a universal investment allocation. However, I will review important aspects of allocation an investor should consider when determining a suitable allocation. The Prospector's model portfolio is designed to represent the stock or equity investments in an investor's overall allocation plan.



"I firmly believe a majority of investors would attain higher returns if they simply added a larger dose of discipline to their investment prescription."

## "BEAT THE MARKET"

The third principle is based on the fact in the long term (3+ years), it is extremely difficult for mutual fund managers to "beat the market." Some reasons managers fail to outperform the market in the long run are high fund management expenses, high costs of trading securities and the law of averages. I believe it is virtually impossible for an investor to choose a fund manager that will consistently outdistance the market averages.

Index funds were developed to mirror indices of overall market performance and in the long term they have provided better returns than most actively managed mutual funds. Index funds invest in stocks proportional to popular stock indices like the Dow Jones Industrial Average or the Standard and Poor's 500 Composite Stock Index. They typically have low turnover, low expenses and closely track the returns of their target index.

These facts are clear, and the Prospector firmly believes in the value of index funds. A substantial portion (40%-60%) of my model portfolio will be invested in index funds. There are many sizes and shapes of index funds and I will identify the index funds capable of providing superior long-term results.

## MANAGERS AND MARKET TRENDS

The fourth element of the investment strategy is based on the fact that in the short run (1-3 years), there are capable managers who handily outperform the market averages. Have you wondered why some managers produce above average returns for a period of time and then have a period of poor performance?

The common term for this is "regression to the mean" as a manager's superior performance is followed by poor performance. What many investors overlook is fund performance is often related more to a specific market style being in vogue in the market, than the manager's stock selection ability.

Market leading funds are usually in groups of funds with similar market styles. For example, mid and small cap growth funds may be the market leaders for several years, while large cap growth and all styles of value funds fall behind the market averages. Investors can benefit from identifying and investing in these style trends.

# Investment Philosophy – The Basics

## SUSTAINED STYLE TRENDS

Style trends often persist in the market for six to sixty months and capturing a portion of the leading trends is often all that is required for an investor to outperform the market averages.

My strategy is to identify and position the actively managed portfolio funds in the leading, broad-based market trends of manager style (growth vs value) and market segment (large, mid or small capitalization, US, European or Asian, etc.).

By investing in the leading one, two or three styles (depending on the market diversity) and limiting exposure in the under-performing styles, the performance of the active managed funds can be superior.

Not all trends or funds identified will work out, but successfully identifying a few major trends and superior funds will more than make up for the trends and funds that disappoint along the way.

## DIVERSIFICATION

Diversification across a large number of funds (8 to 12) is important, as I do not want significant overlap of investments or management styles. Diversification is especially valuable in declining markets as it can lower risk.

It is also important to maintain representation across the three major size market segments (large, mid and small cap) because often the start of a new style trend is not easily discernable and I do not want to miss out on initial gains. Fortunately, as trends strengthen, they become obvious and easier to participate in.

## INTERNATIONAL INVESTING

Investing internationally is another principle of my strategy. Many financial studies show a portfolio holding international equities can enhance returns and lower the overall risk of the portfolio. Accordingly, I invest a portion (10% to 25%) of the model portfolio internationally.

The international markets also exhibit segment trends and I employ the same actively managed fund strategy with the international segment of the portfolio. I look for major style trends in the international markets and invest in the better performing funds within the stronger market trends. It is simple and it works.



“...successfully identifying a few major trends and superior funds will more than make up for the trends and funds that disappoint along the way”

## TAX CONSIDERATIONS

Taxes are very important when considering the actual total return of a portfolio. Paying 28% or more of your profits to the taxman reduces actual returns more than most investors realize. A trader must earn 28% to 43% higher returns to equal the after-tax returns of the buy and hold investor. That’s quite a hurdle for the trader to overcome. Over the long term, a trader must earn more than 20% to equal a capital-gain favored, 14% investment return. The odds are certainly not in favor of the trader.

The Prospector prefers to keep his profits working in the market and doesn’t like to pay more taxes than necessary, so I won’t be trading funds unless a change is dictated by market trends or manager performance. I don’t believe in cash vs stock market timing, so other than reacting to a change in overall asset allocation strategy, I recommend being fully invested in the market almost all the time.

## PROSPECTOR’S STRATEGY

To sum up the Prospector’s strategy, I recommend investors follow a disciplined investment strategy employing adequate asset allocation between stocks, bonds and money market investments.

The equity allocation and strategy invests a substantial portion of the portfolio in index funds (40%-60%) as a long-term, core position and invests the balance of the portfolio across all major market size segments, favoring better performing funds in the better performing market styles.

A portion of the portfolio is invested internationally, again favoring the better performing market styles. Generally, funds are held for the longer term to benefit from lower, capital gain tax rates.

By combining these two time-tested strategies in a disciplined manner, investors have the opportunity achieve superior results.

You don’t have to buy, hold and hope your funds will do well with equity style timing.

The article, “Equity Style Timing” on the next page, explains the opportunity for investors employing style timing from an academic perspective.

# Academic Alley – “Equity Style Timing”

I recently read an interesting study related to the allocation strategy I use to manage the Prospector’s model portfolio. The study was done by two employees of General Motors Investment Management Corporation, Duen-Li Kao and Robert Shumaker. The study, “Equity Style Timing” appeared the Jan/Feb 1999 issue of the Financial Analysts Journal.

Without delving into all the methodology and statistical formulas, I would like to share some of the major findings of the study. Interested readers might be able to pick up a copy from their local library.

The authors were quick to point out there have not been many studies on what drives cyclical style return differences or whether and how tactical style allocation can be effectively achieved. This statement reinforces my notion, that the Prospector’s strategy of market style trend following, is not widely practiced or studied by market researchers.

I found the following statement very intriguing. “Timing strategies based on size, style and market have been attractive to investors as potential sources of added value.” In their study, Kao and Shumaker set out to determine what the benefits of equity style timing (also know as tactical or dynamic asset allocation) would be to investors successfully employing a “perfect” timing system.

Academic studies like this one, often show what the “**excess returns**” (performance beyond the average market return) could be, if an investor had the benefit of perfect foresight in making investment decisions. The results show there are significant opportunities for excess returns, if an investor can successfully invest in the correct market style at the right time.

The study looked at three types of style timing: size (large cap vs small cap), style (value vs growth) and market (stocks vs cash). Kao and Shumaker analyzed market returns for the period of January 1979 through June 1997.

They determined performance if an investor made perfect timing decisions every month and every year.

Potential Above-Market Returns from Equity Style Timing

Benefit of Equity Timing Strategies		
Size	Large Cap	Small Cap
Monthly	20.8%	27.3%
Annual	7.0%	10.4%
Style	Value	Growth
Monthly	24.6%	34.5%
Annual	7.8%	11.4%
Market	Mkt/Cash	Bonds
Monthly	48.2%	43.2%
Annual	15.4%	12.6%

As you would predict, making the correct investment decision every month increases returns substantially compared to once a year.

The results show perfect size selection by market cap could add 20%-27% annually to market returns with monthly decisions and 7%-10% with annual decisions. Granted, these are perfect decisions, but the excess returns are phenomenal! Annual excess returns of 7%-10% would make Peter Lynch look like a rookie stock picker!

Perfect style selection, value versus growth, would garner even greater market returns, 24%-34% with monthly decisions and 8%-11% with annual decisions. There appears to be considerable opportunity for investors positioning their portfolio in the leading market segments.

The world of perfect market timing does the best of the three style selections with excess returns of 48% monthly and 15% with annually decisions. Next month I’ll report on some recent, actual market timing results. Hint - this doesn’t work and the follow-up article showed how poorly (cash vs market) market timers actually perform. If someone knows how to time the market (cash vs market) they sure aren’t talking about it.

**The results of this study demonstrate the substantial opportunity associated with style allocation strategies.** In reviewing graphs of the last twenty five years of market style activity, there are many, highly discernable, extended periods when specific size/style combinations significantly outperform their peers.

An investor identifying these leading market sectors and shifting the actively managed portfolio funds into these segments has the opportunity to outperform the market and a solution to his performance dilemma.

The article on the next page provides examples of how market size and style segments perform during different time periods. Two final thoughts...First, it is a proven fact, index funds provide superior long term returns. Second, equity style timing offers a substantial opportunity to outperform the market averages.

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# Investment Philosophy – Style Allocation

The equity portion of an investor's portfolio should be allocated across different asset classes for diversification and to enhance performance. Mutual funds can be divided into different classes using several criteria including style and the size of companies the fund invests in. Often the fund charter and name indicates the class of fund - Small Company Growth or Mid Cap Value Fund.

Fund styles can be growth or value oriented or the combination (mixed) of both. Company size is usually measured by market capitalization, which is the number of company shares outstanding times the market price of a share. Market capitalization is generally divided into large companies (\$7.5B+), medium size (\$1.0 to \$7.5B) or small firms (< \$1.0B). Additional criteria can include where the fund invests (US, worldwide, foreign, single country, etc.), as well as, the type or number of securities the fund holds (single industry, focused, dividend paying, etc.).

Studies show diversification lowers investor risk. This means investors should own stocks in several asset classes to lower overall

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The table presented here shows returns for six asset classes over twenty years. You can see there were periods of market leadership associated with each asset group. Often, market leadership was concentrated in one or two asset classes and the high performance extended for

more than one year. This is the type of market style trend I want to identify and invest in. By shifting the portfolio toward the higher performing market segments, the investor benefits from higher returns. This process of managing the actively managed funds in the portfolio is known as tactical style allocation.

It is not always easy to identify these trends as they develop. That is why it is important to

maintain representation across all the major market size segments. One of the benefits of holding the index fund is that it participates in all market size and style trends.

Studies show holding three funds in an asset class provides ample opportunity for superior relative performance while providing adequate diversification. Holding more than three funds in an asset class generally reduces performance without significantly increasing diversification.

Notice the international sector provided the top returns during seven years. That is why the strategy includes an allocation to international funds.

Generally, the Prospector's portfolio contains eight to twelve funds

four funds in the heaviest weighted styles and a minimum of one fund in every size sector.

Style allocation is the investor's friend or foe depending on how it is employed. Prudent investors should diversify to reduce risk and use equity style timing to increase performance.

The article on the next page shows how I identify the better performing market styles.

Asset Class Returns						
Year	LC Gwth	LC Val	SC Gwth	SC Val	Int'l G	Int'l V
1979	18.4	23.8	43.2	38.0	4.8	4.4
1980	32.4	16.5	41.9	29.1	22.6	18.0
1981	-4.9	11.2	-2.7	10.5	-2.3	13.6
1982	21.4	27.4	28.0	37.7	-1.9	2.5
1983	22.5	26.8	39.7	44.2	23.7	31.5
1984	6.3	14.1	-6.7	5.1	7.4	7.6
1985	32.2	29.5	24.7	34.7	56.2	67.3
1986	18.5	20.4	6.9	16.7	69.4	70.2
1987	5.2	2.3	-9.3	-6.3	24.6	31.2
1988	16.8	24.6	22.9	28.8	28.3	33.5
1989	31.5	28.4	10.2	19.7	10.5	24.7
1990	-3.2	-13.9	-21.6	-20.8	-23.4	-15.6
1991	30.1	29.8	44.6	39.4	15.9	12.3
1992	7.3	21.2	23.4	29.9	-13.1	-3.1
1993	9.6	20.2	21.0	25.8	25.9	47.2
1994	1.3	-4.5	3.1	1.2	5.3	8.8
1995	37.1	38.4	34.5	29.3	13.1	11.5
1996	22.6	20.2	17.6	22.3	6.3	7.8
1997	33.1	28.1	22.8	30.8	5.5	-3.1
1998	28.6	11.8	-7.4	-7.6	18.2	14.8
Avg	18.3	18.8	16.8	20.4	14.9	19.3
Std Dev	13.0	12.6	19.6	17.9	21.1	22.3
Highest	5	2	3	3	0	7
Lowest	4	2	5	1	4	4

# Nuggets Lead the Way

Style trends in the market are common and investors capitalizing on favorable trends are often generously rewarded. A key element of the actively managed fund strategy is to identify and invest in these trends.

Studies show stocks often exhibit “price momentum” in the market. Typically, a stock price will rise in an industry or sector of the market when the economic climate turns favorable for the industry. As companies report increased sales and earnings, investors see improved operating results and drive the stock prices higher.

Momentum theory says companies whose earnings and stock prices have recently risen the most will continue to do so as investors anticipate continued financial improvement.

The rising stock prices exhibit “momentum” because the upward price trend usually persists for six months or longer as companies financials continue to improve from quarter to quarter. Many “growth style” managers use this technique of stock selection and their funds tend to exhibit a similar upward price momentum.

My “Nugget” rating system quickly sorts through the high volume of return information and identifies the major style trends in the market and the better performing funds in these styles.

Nuggets are computed by comparing short term (1 yr and under) performance with market averages. Average market performance receives a rating of 10. Ratings above 10 indicate above market performance, while ratings below 10 reflect below market performance.

The Nugget ratings for fund classes (large, mid and small cap - growth and value style) and index funds provide a good indication of relative style strength. This information helps determine the overall target portfolio mix. Nuggets are also used to identify a style’s top performing funds.

The graphs on this page show how market styles are tracked by the Nugget ratings. The 1998-1999 graph shows Nugget ratings of market styles based on market indexes.

Large cap growth and large cap value funds were the top performers during this period, while small and mid cap value funds were under-performers. Notice the small and mid cap growth funds strong upward trend starting in Apr-May 1999 and crossing the large cap value line in Jul-Aug 1999.

By following these style trends, the actively managed funds in the Prospector’s model portfolio returned a stellar 72.1% during 1999. This compares quite favorably to the overall 1999 market return of 23.8%.

Market leadership during the 1992-1993 period was very different, but the Nuggets clearly identified small and mid cap value styles as top performers, while large cap growth under performed.

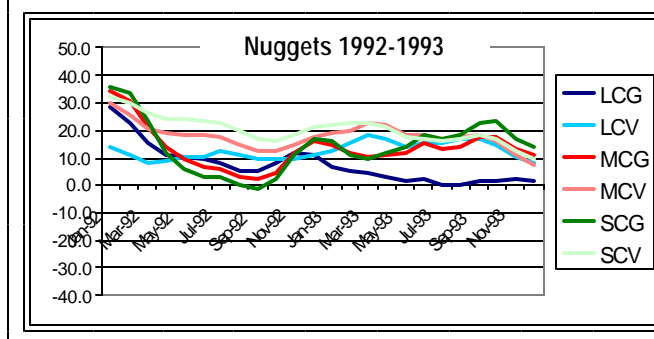
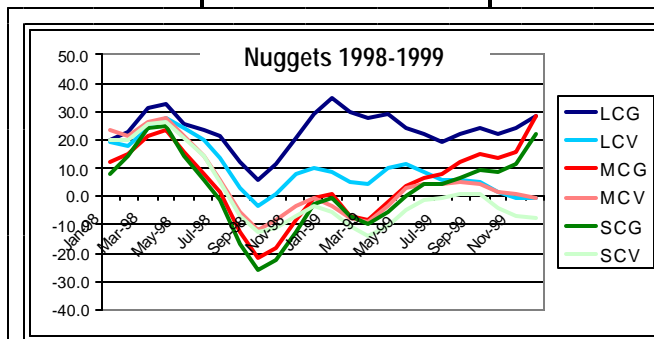
During this two year period, small cap value returned 47.5% and mid cap value returned 38.4% compared to 5.4% for large cap growth. In both examples, small, incremental changes in portfolio mix was all that was required to participate in the major

style trends. Rapid, major portfolio restructuring was not required to garner superior returns.

Significant style differences like these two examples do not always occur, but when they do, investors capitalizing on them are rewarded with above average returns. Additionally, when one market style is significantly under-performing, investors would be well-advised to not invest in that style.

By maintaining portfolio performance close to the overall market with the core index funds during uncertain periods and outperforming the market with actively managed funds during opportune times, the investor can outperform the market...

*Follow the Nuggets!*



# Fund Performance Information

**E**ach month the Mutual Fund Prospector newsletter provides investors current fund information on 350+ funds. The funds are grouped according to their equity styles of size; large, mid and small cap, and investment management style; growth, mixed or value.

The fund information provided includes symbol, category, market cap, style, Nuggets, Nugget rank, ytd, 3, 6, 12 mo. 3, 5 and 10 yr. returns, fund size and risk information. The funds are ranked by one year return and index fund benchmarks are presented for market style comparisons.

Nuggets are computed by comparing fund 3, 6 and 12 month performance to the Vanguard Total Stock Market Index Fund. The Nugget ratings help determine the better performing market styles and individual funds.

For example, in March 1999, the Prospector's model portfolio contained ten funds and the actively managed fund allocation was based primarily on the Vanguard Index Fund Nugget ratings. The model portfolio allocation at this time was

<i>Large Cap</i>	<i>80%</i>	<i>Growth Style</i>	<i>80%</i>
<i>Mid Cap</i>	<i>15%</i>	<i>Mixed Style</i>	<i>20%</i>
<i>Small Cap</i>	<i>5%</i>	<i>Value Style</i>	<i>0%</i>
<i>Domestic</i>	<i>90%</i>	<i>International</i>	<i>10%</i>

You will notice the growing style strength (6 mo returns) in the Pacific and mid cap sectors and the declining, but still strong, large cap growth sector. During ensuing months, as these trends strengthened, I shifted a portion of large cap growth funds into international (Pacific) and mid cap funds. These sectors continued to outperform the market into 2000.

<b>Vanguard Idx 2/26/99</b>	<b>Nuggets</b>	<b>ytd</b>	<b>3 mo</b>	<b>6 mo</b>	<b>1 yr</b>
<b>Vang Gwth Idx</b>	<b>17.5</b>	<b>2.0</b>	<b>7.0</b>	<b>17.9</b>	<b>30.8</b>
<b>Vang S&amp;P 500 Idx</b>	<b>12.4</b>	<b>1.0</b>	<b>4.7</b>	<b>15.2</b>	<b>19.8</b>
<b>Vang Tot Stk Mkt Idx</b>	<b>10.0</b>	<b>-0.2</b>	<b>4.3</b>	<b>14.1</b>	<b>14.1</b>
<b>Vang Value Idx</b>	<b>6.6</b>	<b>-0.2</b>	<b>1.7</b>	<b>11.4</b>	<b>7.7</b>
<b>Vang Int'l Euro Idx</b>	<b>6.4</b>	<b>-3.4</b>	<b>1.3</b>	<b>5.6</b>	<b>10.9</b>
<b>Vang Total Int'l Idx</b>	<b>5.6</b>	<b>-2.8</b>	<b>2.1</b>	<b>12.5</b>	<b>4.2</b>
<b>Vang Mid Cap Idx</b>	<b>3.9</b>	<b>-8.7</b>	<b>0.3</b>	<b>13.1</b>	<b>-1.0</b>
<b>Vang Ext Mkt Idx</b>	<b>2.9</b>	<b>-4.1</b>	<b>3.0</b>	<b>10.6</b>	<b>-2.1</b>
<b>Vang Pacific Idx</b>	<b>2.8</b>	<b>-1.4</b>	<b>-1.0</b>	<b>21.2</b>	<b>-7.3</b>
<b>Vang Sm Cap Idx</b>	<b>-4.1</b>	<b>-7.0</b>	<b>-1.6</b>	<b>3.8</b>	<b>-14.8</b>
<b>Vang Int'l Emgr Idx</b>	<b>-12.0</b>	<b>-0.8</b>	<b>-5.7</b>	<b>-18.6</b>	<b>-21.0</b>

The excerpt of the June 1999 small cap table shows the performance of funds in this market segment. Notice the top six funds are in the top 20 of all funds ranked. The top six funds have high Nugget ratings and are significantly outperforming their index benchmarks. Choosing appropriate funds from this list should not be difficult.

Besides Nuggets, an investor should assess style, fund family, risk, size and recent performance in selecting funds for further consideration. When adding funds to the portfolio an overlap analysis is recommended to make sure the new fund does not hold the same stocks as existing portfolio funds.

There are many index funds to choose from. Index funds are available for almost every style. I recommend using a very broad-based fund covering all US stocks for a core portfolio position. Schwab and others offer index funds tracking the Wilshire 5000 index. This is a capitalization weighted index of all the regularly traded stocks on the NYSE and NASDAQ/AMEX. This type of broad-based index fund is a good choice for the core index fund.

<b>Small Cap 6/25/99</b>	<b>Symbol</b>	<b>Rec</b>	<b>MCap</b>	<b>Style</b>	<b>Cls</b>	<b>Nuggets</b>	<b>Rank</b>	<b>ytd</b>	<b>3 mo</b>	<b>6 mo</b>	<b>1 yr</b>	<b>3 yr</b>	<b>5 yr</b>	<b>10 yr</b>	<b>Assets</b>	<b>Risk</b>
RS Emgr Gwth	RSEGX	BBuy	SC	G		50.0	6	36.8	14.2	41.1	71.5	29.9	26.7		S	10
Berger New Generation	BENGX	BBuy	SC	G		41.5	8	36.3	27.0	42.1	48.9	29.0			S	8
RS Divrs Gwth	RSDGX	BBuy	SC	M		39.5	10	34.8	23.4	38.0	48.7				VS	8
Transamerica Sm Co	TPSCX	BBuy	SC	G		27.8	19	12.1	8.4	14.9	45.3				S	5
Janus Enterprise	JAENX	BBuy	SC	G		31.0	17	21.4	7.5	30.9	42.4	20.3	24.6		M	6
Fremont US Micro	FUSMX	BBuy	SC	G		31.9	14	29.4	30.6	35.6	32.1	17.5			S	10
Janus Venture	JAVTX	Buy	SC	G	Cls	21.8	30	16.1	10.2	21.5	28.4	16.5	19.8	15.8	L	6
Founders Discovery	FDISX	Buy	SC	G		23.1	29	16.8	23.0	24.2	24.4	14.0	20.5		S	9
SAFECO Northwest	SFNWX	Buy	SC	M		8.3	103	9.8	6.8	11.7	8.8	14.9	15.5		VS	9
Wasatch Micro Value	WMCVX	Buy	SC	V		12.2	62	9.2	21.4	16.1	8.2				VS	3
<b>Vang Ext Mkt Idx</b>	<b>VEXMX</b>	<b>Hold</b>	<b>MC</b>	<b>M</b>		<b>8.5</b>	<b>97</b>	<b>7.3</b>	<b>9.0</b>	<b>12.3</b>	<b>8.0</b>	<b>16.4</b>	<b>19.4</b>	<b>13.9</b>	<b>L</b>	<b>8</b>
Schwab MktMgr SC	SWOSX	Hold	SC	FOF		9.0	91	12.0	12.9	14.8	5.8				S	8
RS Micro Cap Gwth	RSMGX	Hold	SC	G		11.8	63	13.2	19.4	20.4	5.6				S	10
Wasatch Micro Cap	WMICX	Hold	SC	G		7.3	113	3.3	14.8	10.2	4.5	18.7			S	8
Berger Sm Cap Value	BSCVX	Hold	SC	V		10.1	77	12.3	19.3	16.9	4.3	15.4			S	6
<b>Vang SC Idx</b>	<b>VSCIX</b>	<b>Sell</b>	<b>SC</b>	<b>M</b>		<b>4.7</b>	<b>137</b>	<b>5.8</b>	<b>13.3</b>	<b>10.2</b>	<b>-0.2</b>				<b>L</b>	<b>9</b>
<b>Vang SC Gwth Idx</b>	<b>VISGX</b>	<b>Sell</b>	<b>SC</b>	<b>G</b>		<b>1.1</b>	<b>163</b>	<b>-1.5</b>	<b>9.7</b>	<b>4.0</b>	<b>-2.1</b>				<b>VS</b>	<b>4</b>
Schwab SC Index Inv	SWSMX	Sell	SC	M		3.0	149	3.8	13.2	8.3	-2.4	10.0	14.5		M	9
Wasatch Gwth	WGROX	Sell	SC	M		2.6	153	2.5	9.6	9.8	-2.6	11.7			S	9
Columbia Sm Cap Inc	CMSCX	Sell	SC	G		0.0	175	0.9	11.7	3.4	-4.8				S	9
<b>Vang SC Value Idx</b>	<b>VISVX</b>	<b>Sell</b>	<b>SC</b>	<b>V</b>		<b>2.5</b>	<b>155</b>	<b>5.0</b>	<b>16.0</b>	<b>9.0</b>	<b>-4.9</b>				<b>S</b>	<b>4</b>
Small Cap Average (sample data / funds omitted)						8.9		8.3	13.6	13.3	6.9	15	19.2	14.1		8

# Don't Buy, Hold and Hope

I believe many investors can improve their mutual fund returns by using the investment strategy outlined in this guide and the information contained in the monthly issues of the Mutual Fund Prospector.

## The strategy is easy to implement and follow

- Establish a core index fund position in my recommended index fund. Invest the same percentage of your funds in the index fund as the model portfolio.
- Invest the balance of your funds in the model portfolio's recommended funds or other BestBuy rated funds following the recommended equity style allocation.
- Monthly, follow the model portfolio recommendations. The strategy does not involve short-term trading.

If the funds in your 401K plan are not included in the 350+ funds rated in the newsletter, you simply invest in the core index fund from your plan and select funds from your plan that are the same recommended equity style. All the information you need to invest successfully is provided each month in the newsletter.

Outside of a 401K plan, I suggest using a fund supermarket like Charles Schwab or Fidelity for your portfolio as this simplifies record-keeping and makes the occasional transaction easy.

You don't need \$50,000 to successfully use this strategy, but you do need approximately \$10,000 to diversify adequately across the major market styles. If you have less than \$10,000, I recommend you invest only in a broad-based index fund.

The Prospector's \$50,000 model portfolio is an actual example of how the Prospector's strategy works. If you have any doubts about how my investment strategy actually performs, you can follow the model portfolio's performance on my website, [www.ericdany.com](http://www.ericdany.com)

The Prospector Newsletter provides complete fund performance data organized in a fashion that complements the Prospector's strategy. It makes it easy to analyze style trends and select better performing funds.

By subscribing to the Prospector, you can use the strategy with your investments and benefit from equity style timing. The newsletter provides extensive performance data sorted by market style and it includes the Nugget ratings along with BestBuy recommendations. You will have all the information you need to successfully manage your portfolio. Here are the actual model portfolio returns.

### Model Portfolio Performance

12/31/1998 - 12/31/2001

3 Years

Return	MFP	Market
<b>Total</b>	<b>45.2 %</b>	<b>-1.7 %</b>
<b>Annualized</b>	<b>13.2 %</b>	<b>-0.6 %</b>

The Prospector's monthly newsletter includes more than fund performance data, as I am constantly monitoring the mutual fund industry to keep abreast of changes and opportunities. I will alert you to new funds, manager changes, interesting financial studies and investment strategies. Content also includes star manager interviews, book reviews, web wanderings and my unbiased, candid outlook on the markets.

If you want to start using a sound, easy to implement investment strategy, you will find the information contained in the Prospector all you need. You can mirror the model portfolio or if you want to "build your own" mutual fund portfolio, you can use the Prospector as a valuable resource providing current, key fund information.

The Prospector helps you to think tactically about today's markets, to maneuver between funds in uncertain markets, to invest safely with adequate asset allocation, to diversify your mutual fund portfolio and much, much more.

Because the market is constantly changing, a fixed allocation strategy is doomed to underperform the market. Don't buy, hold and hope your funds will do well - Become a flexible investor and Follow the Nuggets!

Invest Successfully,

Eric Dany



The Prospector Mines  
Mutual Funds for  
Your Benefit

The Mutual Fund  
Prospector's  
Performance is  
Tracked by the  
Hulbert Digest

## Mutual Fund Prospector

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E-mail: [editor@ericdany.com](mailto:editor@ericdany.com)  
Customer Service: 309-736-9376  
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