



Advisers warn against dumping money-market funds

Despite rise in money-market assets, short-term ETFs aren't seen as way to go

By Murray Coleman, November 14, 2007

SAN FRANCISCO (MarketWatch) -- With money-market mutual funds scrambling to cover their costs as credit meltdowns spread, some advisers say they're seeing more interest from high net-worth clients in short-term, bond exchange-traded funds.

One of those is Jerry Slusiewicz. But the president of Pacific Financial Planners in Newport Beach, Calif., doesn't recommend investors pull out of their money-market funds just yet.

Several major financial services firms have moved to protect money-market assets in recent months. The latest is Bank of America Corp. , which on Tuesday said that it plans to use a \$600 million reserve to shore up a group of its money-market funds. Another big financial-services firm, Legg Mason Inc. , has made public plans to establish credit lines of roughly \$238 million to keep intact credit ratings of two money-market funds.

On Wednesday, a new Money Fund Report found that taxable money-market fund assets rose by \$9 billion to a record \$2.53 trillion in the latest week.

Concern about economic conditions is seen as the most likely rise in money-market assets. But as more investors look for safe havens to stash cash, advisers are warning against getting too creative.

"It's not time to panic by any means," according to Slusiewicz. "The banks and fund companies have to make things right with traditional money-market funds. It would just create too much of a loss in confidence if they let such a conservative investment vehicle get into trouble."

Ben Jacoby, a founder of Brinton Eaton Wealth Advisors, agrees. "If you look at their history, the chance of these things failing is practically none," he said. "People just have to make sure they purchase high-quality and competitively priced funds from well-respected managers such as Fidelity and Vanguard. "

The Morristown, N.J.-based adviser added that short-term ETFs aren't necessarily a poor option in today's dicey credit market. "Whatever direction you go, either mutual funds or ETFs, make sure they're invested in high-quality government obligations," he commented.

On the plus side, advisers point to fairly stable prices for short-term bond ETFs.

Since they can be bought and sold throughout a weekday -- unlike standard mutual-funds -- Slusiewicz said that ETFs might seem particularly attractive, in light of recent moves by major banks and financial firms to fund their money-market portfolios.

But like other advisers, he's cautioning that such a tactic has plenty of risks. These make it unlikely that investors are ready to stage a mass exodus from money-market funds, according to Carl Delfeld, president of Chartwell ETF Advisor, a Denver-based consultant and money manager.

Since bonds are expected to trail stock returns by a wide margin in the longer term, Delfeld said that buying a short-term bond fund with low costs is more important than the ongoing credit crisis.

He uses iShares Lehman 1-3 Year Treasury Bond in his portfolios. Delfeld also tracks the new SPDR Lehman 1-3 Month T-Bill .

"If you're worried about a money-market fund's credit status, I'd blend short-term bond ETFs into the mix," Delfeld advised. "But I wouldn't go with one over the other."

Individual investors tend to fall into the trap of using ETFs' increased trading flexibility too much, he commented.

"With money-market mutual funds, they'll usually make contributions and forget about it," Delfeld said. "With ETFs, they're more likely to keep track of their price fluctuations. The minute they see red, they panic and dump it."

Keith Newcomb, a Nashville, Tenn.-based adviser, also uses short-term bond ETFs for fixed-income allocations of his clients.

"They're good alternative if assets look to be more at-risk in regular money-market funds," he said. "But it hasn't gotten to that point yet. The funds we use haven't run into problems."

Commissions on ETF trades typically run around \$10 per transaction for his accounts, Newcomb commented. "Fees on ETF transactions have dropped a lot in recent years. But someone with a relatively small account or who is inclined to trade a lot still probably isn't the best type of investor to put into any sort of short-term bond ETF in place of a money-market fund."

The potential to gain greater capital appreciation in a short-term bond ETF isn't really that much of an advantage, argues Kevin Meehan, a Chicago-area adviser.

"The characteristics of ETFs aren't consistent with what most people are going to be looking for in a money-market investment," he said. "While short-term ETFs are usually very safe, they're not without some degree of share-price fluctuation. Even the SPDR 1-3 Month ETF may not maintain the same stability on a daily basis as most money-market [assets] still do."

Still, he and other advisers say that they're paying close attention to the ongoing credit crisis and bailouts of money-market funds.

In the case of Slusiewicz, he's also watching the situation since he also serves as chairman of the Orange County Treasurer's Advisory Committee, in California.

"We've got a big concern that this credit crisis doesn't break the bank, so to speak," he said.

The group is made up of financial professionals to advise policy for the county's money-market pool. Right now, that stands at \$7 billion in assets. Of that total, some \$5 billion is run as a straight money-market account. The remainder is managed with longer-duration fixed income, ranging on average between two to two and a half years.

Orange County, of course, declared bankruptcy in 1994 over risky investments such as derivatives. "Back at the same time, banks had similar problems with short-term fixed income markets," Slusiewicz said. "That's the last time we saw a money-market crisis like we are today."

He added: "We're not worried at all about Orange County's situation right now. We've got very little exposure to commercial paper and we're constantly monitoring the situation."

The county's money-market pool has reduced its stake in asset-backed commercial paper with less than one year in duration. It's down to about 4% through October, Slusiewicz estimates. In July, that was running in the low-double digits.

"But we were looking at \$890 million or something tied to [asset-backed commercial] paper, which is where we find most of the risk now," he added. "We call it toxic-backed paper."