The Mutual Fund Business

Author: **Robert C. Pozen**
Publisher: The MIT Press[1]

Reviewer: John E. Grable
Kansas State University
School of Family Studies and Human Services

The year was 1980, and the United States was just turning the economic corner as it dealt with the stifling effects of inflation and high unemployment of the 1970s. Back then investors were fixated on investing in hard assets such as gold, silver, coins, and jewels. Investors who ventured into equities or bonds were often considered icons of the past. After all, stocks had still not recovered from their tremendous losses of the 1973-1974 bear market. Worse still were attitudes about those investors who relied on mutual funds as their conduit to investing in assets. In 1980 mutual fund assets held by investors, including equities, bonds, real estate, and money market instruments, equaled less than $150 billion in total.

This small sum invested in funds was the result of (a) the general unpopularity of the equity markets, (b) the under-promotion of mutual funds, and (c) an underpinning of distrust of mutual fund promoters (the fund industry was still reeling from manipulations, high fees, and bad investments that left fund investors poorer for their investments). The early 1980s marked a turning point in the mutual fund business. It was just around this time that investors began to view mutual funds as a respectable investment alternative.

Jump ahead to 1999. In less than two decades mutual funds have grown in size and scope so that as of today, mutual fund assets exceed $5.0 trillion. This amount exceeds all assets held in bank deposits. Further, within the past ten years the number of mutual funds, now more than 9,000, is greater than all of the stocks traded on the major exchanges. The majority of individual investors now own most of their equity investments through mutual funds, and a growing number of professional asset managers are using mutual funds, rather than direct investments, as tools when creating portfolio asset allocations.

Given the enormous growth in popularity of mutual funds by both individual and professional investors one might assume that both extensive empirical research and applied mutual fund textbooks would be prevalent. In fact, the opposite is true. Little research, when compared to direct ownership investment research, has focused on the techniques, implications, and strategies involved with mutual fund investing. The number of trade magazines, which focus on mutual fund investing, can be counted on one hand. Even worse, however, is the lack of applied and practical textbooks that are written for and about mutual funds. The good news is that Robert C. Pozen, a highly respected name in the mutual fund industry, has taken an enormous step in filling the void in the mutual fund textbook market by publishing The Mutual Fund Business through the MIT Press.

Pozen has overseen the development of a textbook that is focused on assisting students understand the fundamentals and details of the mutual fund business. The textbook leads students through fundamental definitions up to sophisticated trading techniques used by mutual fund portfolio managers. Almost everything one would want to know about the fund business is here. The book consists of 13 chapters. Each chapter begins with a simple introduction. Selected readings, case studies, and exercises, generally written by other contributors, follow each introduction. In this way Pozen is able to draw on the expertise of professionals, academics, fund managers, and journalists, to bring certain key concepts to light. As Pozen states, this book is "not a textbook attempting to summarize all relevant facts and present definitive conclusions on every aspect of the industry" (p. xii). Each section, of which there are four, and each chapter are designed to stand-alone. Section one provides an overview of the fund industry. Section two looks in detail at portfolio management and equity trading. Section three reviews fund marketing and fund shareholder services, while section four deals in-depth with specific fund topics, such as the role of technology in fund trading, the sale of funds to non-U.S. investors, and international investing.

While all the relevant and important pieces related to the mutual fund business are to be found in the book, the order of chapters might cause confusion for readers with

1. *1998, paperback, 727 pages, ISBN: 0-262-66141-1. Publisher web site: mitpress.mit.edu*

©1999, Association for Financial Counseling and Planning Education. *All rights of reproduction in any form reserved.*

a limited knowledge of mutual fund investing. For example, outside of the brief preface, a clear definition of a mutual fund is not presented until page 16. This suggests that while the purpose of the book is to help students understand the fund business, Pozen may really be positioning the book as a first course textbook for professional mutual fund executives who already have a fundamental knowledge of investing and mutual funds.

An instructor wishing to use this textbook as a stand-alone product for a course should have a high level of familiarity and knowledge of the fund business. Although someone with little or no knowledge of the fund business could sit down and begin reading this book with little confusion, it is more likely that without guidance from someone familiar with fund investing, the readings would generate more questions than answers. Questions associated with the cases and exercises are practical and should provoke much discussion and debate, but without guidance from an instructor's manual, these discussions may result in unanswered frustration on the part of students and instructors. As such, the text is most appropriate as supplemental reading for a senior level investment, portfolio management, or asset allocation class in a family financial planning or business finance curriculum. The textbook is particularly appropriate as material for an in-house mutual fund training course.

Although problems do exist (as they do in any first edition book) instructors thinking about using the book for a course should definitely take the opportunity to review it. There are three chapters alone that are worth the price of the book. Chapter six discusses brokerage transactions for mutual funds. An article titled "Big-Block Trading Pits Institutions, Dealers in a Fast, Tough Game," written by Randall Smith from The Wall Street Journal provides an excellent example of a side of the money management business few ever see. In this article the author describes how institutions like mutual funds trade millions of shares, and how others look for ways to profit from mistakes large traders occasionally make. For students interested in the fast-paced action of investing, this article provides a unique glimpse into opportunities that exist for those with the acumen for risk taking and an understanding of finance.

Chapter seven is also of interest. The next time a student insists that the only jobs available for financial planning students involve selling insurance, ask them to read "Doing the Wholesaler Dodge" by Mark Henricks reprinted in chapter seven from Registered Representative. While not a recipe for obtaining a dream job, the chapter and article allude to an occupation that family financial planning majors are uniquely qualified to obtain: Wholesaler. Basically a wholesaler is the liaison between a mutual fund and the selling brokers. It is a tough but potentially lucrative occupation. Henricks' article provides a blue print for use by anyone who wants to become a successful and trusted wholesaler. For example, personal characteristics like punctuality, honesty, diligence, creativity, and an excellent knowledge of financial planning techniques and strategies are attributes most financial planning curriculums cultivate in students. As suggested in this chapter, students with these characteristics who learn about alternative financial planning careers stand to make an impact on the profession.

Finally, chapter eight examines mutual funds in relation to retirement plans. An article titled "Keys to Employee Investing Success" describes how financial planning professionals can focus on the investor rather than the investment, thus improving customer satisfaction, investor confidence, and ultimately, opportunities for financial planners. The article discusses how individuals invest in terms of money attitudes, the importance of diversification, investment alternatives, and evaluation techniques for plan sponsors. For those interested in investor risk assessment, this article outlines and defines three types of investors: (a) insecure investors, (b) comfortable investors, and (c) confident investors. According to the article, 40% of investors are insecure, while 28% are comfortable, and 32% are confident. The descriptions and implications of these assessments could easily become the focus of an in-class discussion of marketing strategies and asset allocation techniques.

The investment world has changed dramatically since the early 1980s. Today it is likely that the majority of graduates from financial planning programs in the U.S. will be involved in the sale, distribution, or management of mutual funds if they stay in the planning profession. Thus, it is imperative that students have a thorough understanding of the mutual fund business. In this respect, Robert C. Pozen's *The Mutual Fund Business* fits the need for a course textbook that will appeal to mutual fund executives, graduate business students, and undergraduate students in senior level courses. Although I would have preferred that chapters in the book be rearranged and that answers, or at a minimum guidelines, to end of chapter cases and exercises be provided, anyone who desires to obtain an inside look at the mutual fund business should consider purchasing this book.

 ©1999, Association for Financial Counseling and Planning Education. *All rights of reproduction in any form reserved.*