

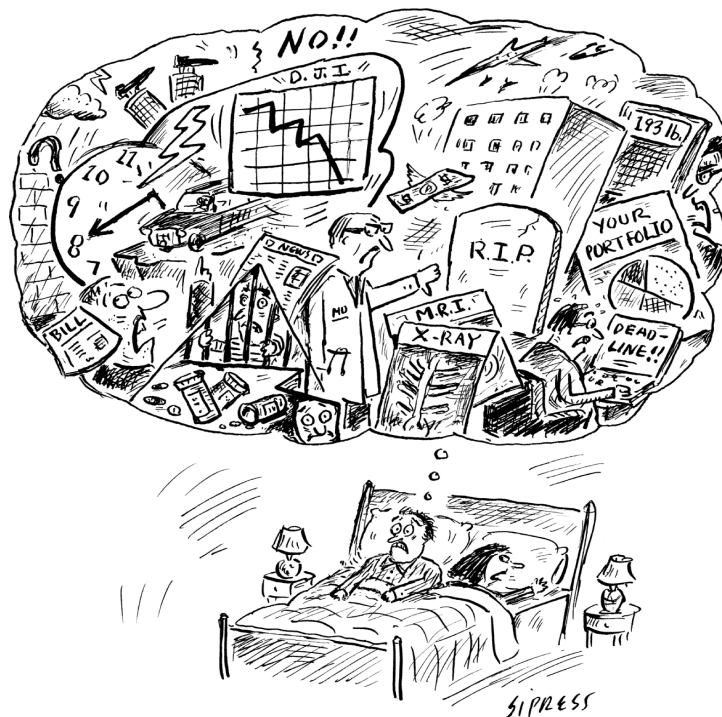


**PACIFICUS**  
CAPITAL MANAGEMENT

INVESTMENT OUTLOOK – JANUARY 2022

## Why I Avoid Mutual Funds

*“The first step towards getting somewhere is to decide you’re not going to stay where you are.” —J.P. Morgan*



*“Try thinking about something else.”*

Happy New Year to clients, friends, and readers. During this time last year, many of us were very hopeful the newly developed vaccines would be the answer to stamping out COVID-19 – unfortunately this did not play out as many of us had expected. Despite this fact, we must all continue to move forward, make any necessary adjustments, but also live our lives. Whether we realize it or not, every day we build on the progress from the previous day. These seemingly small improvements add up overtime, ultimately bringing us closer to our goals. I continue to be steadfastly optimistic about the future and hope you all share in my enthusiasm.

Now would also be a great time for me to thank our clients for introducing us to their friends and family members throughout the year. This is a tremendous complement and a huge responsibility – something we will never take lightly.

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Like years past, I think it makes sense to kick this year off with a shout out to both existing and prospective clients regarding their assets held away, particularly in mutual funds. **If you possess financial assets that sit in an old company 401K retirement plan, or with an adviser who mostly picks mutual funds instead of doing the job of managing an investment portfolio consisting of individual stocks, bonds, exchange traded funds and alternative investments, it may be time to move on to a professional that is better able to serve your needs.**

Mutual funds are a one size fits all solution for the masses. They over-diversify, meaning in many cases needlessly hold hundreds of issues, which all but guarantee higher internal transaction costs and mediocre results over the long run. In addition, mutual funds and some of the advisers who heavily utilize them may be an inferior choice due to their:

- **Tax Disadvantage** – Mutual funds have certain tax disadvantages that can negatively impact returns. Like individual securities such as stocks and bonds, profits in mutual funds are subject to capital gains tax. However, with mutual funds an investor will be held accountable for any capital gains the fund has throughout the year. As an investor, you have no control over when or what the fund sells or when it distributes these capital gains to you. For example, a mutual fund could have purchased shares in a company many years ago whose stock then increased in value. A new investor may have bought into the mutual fund after the gains in the stock occurred and therefore not received any of the benefit of the share price increase. However, when the fund goes to sell those shares, all current investors will be subject to the full amount of capital gains tax – whether or not the investor profited from the past purchase of those shares. Additionally, mutual fund capital gains can be incurred as the result of investor redemption requests, as the portfolio manager running the fund may need to sell securities to cover these sales requests. Also, because capital gains in a mutual fund are distributed to the shareholders of the fund, an investor could end up paying taxes on gains in a year where he/she didn't sell any shares themselves or even worse when the overall fund had a losing year. In other words, an investor can lose money in a mutual fund and still have to pay taxes.

- **High Fees or Complex Costs** – Typically a separate account investment manager/adviser charges somewhere in the ballpark of 1% of assets under management. However, in addition to this charge the mutual fund company/manager must also be paid as well. Mutual fund expense ratios can be as little as a couple of basis points but as high as a couple of percentage points and include management fees, 12b-1 fees (marketing), administrative fees, and operating costs. Additionally,

many mutual funds have high trading turnover within their portfolios, which can mean investors are paying implicitly more in both trading commissions and bid/offer spreads. Personal Capital, a robo-advisor firm published a table of estimated charges by large institutions who heavily utilize mutual funds, which was then re-published in Financial Advisor IQ in late 2017 [here](#). Simply put, if you are paying an investment advisory fee of 1% to your investment manager/adviser and additionally paying a mutual fund expense ratio of 1% then you are needlessly paying at least 2% away in fees annually for the management of your investment portfolio. This 2% figure is the hurdle rate an investor's investment portfolio would need to achieve each year before he/she begins to make a profit. The question an investor should ask – why am I paying double fees for an investment manager/adviser to simply pick mutual funds for me?

- **Inability to Personalize** – A mutual fund is an investment vehicle which pools together many investors' assets. For this to work well, each investors' return objectives and risk tolerance should be similar. Factors such as investment time horizon, allocation preferences, ethical considerations, tax situations, concentrated investment positions, liquidity and income needs can vary widely between investors. Mutual funds are a generic, one size fits all investment vehicle for the masses.

- **Poor Communication** – Investors in mutual funds should not expect to communicate directly into the fund investment management team. Instead, investors will be assigned a sales representative whose main objective is to sell more mutual funds, not manage investments. Mutual funds can have thousands of shareholders, which makes communicating directly with a portfolio manager difficult. Investors who have questions about strategy and or portfolio changes will be unable to speak with anyone but a sales representative. Additionally, it is unlikely a mutual fund manager or sales representative will contact investors to see if their investment objectives have changed and if that particular mutual fund still fits their circumstances.

Keep in mind, there may be situations in which a mutual fund is suitable, such as when investing within company 401(k) plans, 529 college savings plans, or participating in a systematic investment plan. Mutual funds also offer professional management and diversification with low minimums. Schedule time to talk with us regarding what is right for you.

If you have questions on my above comments or would like more information on how we do things differently, feel free to reach out anytime. There is never any obligation to speak with us and we really enjoy helping people.

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U.S. markets have kicked off the year on the back foot. This doesn't feel good, but also should not be a surprise after three years of above average returns and a pivot to a hawkish leaning Fed. Equity risk has been marginally dialed back in portfolios with

much of the proceeds allocated to long term U.S. Treasury bonds. I realize many people believe inflation will persist and therefore long-term bonds could decline in price – I happen to see things differently.

For me, many of the factors that have recently added to inflationary pressures are diminishing, such as supply chain disruptions, the effect of emergency government fiscal policy, and loosening monetary policy. On the other hand, the long-term headwinds we face, such as high and increasing debt servicing costs throughout the developed world, aging demographics, technological advancement, both low-cost labor and greater competition via globalization are all persistent and broadly disinflationary forces. These are the reasons I believe inflation, growth, and bond yields have steadily declined for decades in the developed world and will continue to do so going forward. Couple this with a Fed now shifting to tighter monetary policy and it won't take much wobbling in the stock market to begin to realize long term bond yields are likely capped and still offer good hedging properties to equity-oriented investment portfolios.

I expect the coming weeks to be a little rougher than what many investors have gotten used to, however this could ultimately push the Fed away from its hawkish tone which in turn would take selling pressure off equities. Ultimately, I believe stock market returns will end the year modestly higher after first going through a little dislocation. 2022 may turn out to be a tough year for passive, consensus driven advisers/investment managers. This is the year to stay alert and remain flexible.

<b>ASSET CLASS &amp; SECTOR OPINIONS</b>		
<b>OVERWEIGHT</b>	<b>NEUTRAL</b>	<b>UNDERWEIGHT</b>
U.S. Real Estate & Related Equities	International Developed Market Equities	Small Capitalization Stocks
Large Capitalization Technology	Emerging Markets Equities	Financial Services Sector
Consumer Discretionary Sector	Gold & Gold Miners	Leisure & Hospitality
Healthcare Biotech & Pharmaceuticals	Energy Related Equities	Materials Sector
Aerospace & Defense	Consumer Staples	Leverage Loans (Floating Rate Debt)
U.S. Treasury Notes & Bonds	Communication Services Sector	Treasury Inflation Protection Securities
Investment Grade Corporate Bonds	Mortgage-Backed Securities	High Yield Corporate Bonds
	Local Currency EMG Bonds	

Sincerely,  
Justin Kobe, CFA  
Founder, Portfolio Manager & Adviser  
Pacificus Capital Management



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