



Elon, Twitter and the Importance of Due Diligence

Tips to help with (and where to look for) your own mutual fund due diligence

Elon Musk – the world’s richest person – recently announced that he was pulling out of his agreement to buy Twitter, saying that there was a lack of information about the number of Twitter users made up by bots. In a letter sent to Twitter, Musk said that Twitter was “in material breach of multiple provisions” of the original agreement. The resulting back and forth could end up in court, but many predict it will end with a (quiet) negotiated settlement.

But the saga does remind us that even the world’s richest person knows the importance of due diligence.

Whether you’re an experienced investor or just a beginner, you probably know a little bit – maybe even a lot – about mutual funds. After all, they have been around since the mid 1920s and it is estimated that about half of U.S. householders now own at least one mutual fund.

But when you buy a mutual fund, how much research are you really doing – besides maybe looking at performance numbers? Here are a few tips that might help with your mutual fund due diligence.

Ignore the Advertising

Don’t fall for a fund just because it has a cool name that sounds like a money-maker, you saw an ad on a cable program or your neighbor mentioned how great it was. Do your own research.

The Prospectus

A mutual fund has to disclose its activities in its prospectus, but when was the last time you read one? In case you didn’t know, you will find a treasure trove of information you need to make an informed decision before you buy. And prospectuses are really easy to find online too at mutual fund firms’ websites.

Mutual Fund Fees

There are many things about mutual funds the average investor might not be aware of – but not knowing about mutual fund fees will end up literally costing you money. And often your fund’s expenses can be higher than you think.

There are the stated expenses (disclosure is required by law and you will find expenses clearly outlined in the prospectus), which include administrative, management and marketing fees, as well as front- or back-end commissions.

Pay close attention to the “Annual Operating Expenses” section, especially the two line-items that report “Management fees” and “Total Operating Expenses.” The Management Fee is how much the fund sponsor gets paid. But the Total Operating Expenses is how much you will pay every single year.

For example, if the total operating expenses are 1.50% and you invest \$100,000, you will be paying \$1,500 a year for that fund.

Look at Cash

Sure a fund manager has to hold onto a certain amount of cash for redemptions and purchase opportunities, but you are paying to own that cash. In other words, you may think your money is 100% invested, but it rarely is.

Portfolio Turnover

It's the measure of how often a fund buys and sells assets, and it can give you an idea of the strategy the fund manager is following. It's hard to say precisely what a "good" turnover figure might be, because it really depends on the investment style being followed.

But if a mutual fund has a portfolio turnover of say 100%, that means that every single name was bought and sold within the year. So it should give you pause.

Fund Manager Tenure

If there's a new manager every three to five years, that may be a red flag. You want someone with a track record leading your fund.

Mutual Fund Rankings and Ratings

Don't focus on Morningstar ratings or Lipper rankings or any other such lists. These rankings and ratings do serve a purpose as they can give you a sense of a fund's risk-adjusted returns and how well it has performed relative to others in its category. But the system has limitations and should not be your sole decision-making metric.

Talk to A Financial Advisor

You don't need to become an expert on mutual funds, but you do need to know the basics. Talk to a trusted financial professional who can help you understand the good, the bad and the fine print.

That's exactly what Elon is doing with Twitter.