Use A Money Manager Or Go It Alone?
by Glenn Curtis (Contact Author | Biography)

Investors that have neither the time nor the patience to actively manage their money have options. They can hire a money manager, a hedge fund manger, or invest in a mutual fund or an exchange-traded fund (ETF). But how is an investor to know which route is the best option? There are several things to consider when deciding how to have your money managed - if it is managed at all. Read on for some food for thought.

Starting Costs
An important consideration for many investors is how much it will cost to get into a particular investment. ETFs can theoretically be purchased one share at a time, so the minimum investment is generally negligible. However, many mutual funds have minimums to open an account. To many people, particularly younger investors, the typical $500-$1,000 or more initial deposit a lofty initial investment. (For more insight, see *Start Investing With Only $1,000*.)

Hedge funds generally have an even higher threshold. Many hedge funds require that their investors own up to $5 million in investments and have a minimum net worth and/or a sizable income stream, typically in the $300,000 range. Some funds have an even higher threshold. (If you don't have the large capital needed to invest in a hedge fund, read *Can You Invest Like A Hedge Fund?*)

Costs
ETFs carry transaction costs that vary depending on the broker the investor uses. However, in many cases, the total costs are quite small - usually less than 2% of the total amount invested. Meanwhile, investment advisory services and money management firms typically charge 1- 2% of the client's total assets per year in management and advisory fees. On top of that, brokerage fees are typically charged; therefore, the annual returns an investor must obtain to break even can easily top 5% or more per year. (For more, see *Don't Let Brokerage Fees Undermine Your Returns*.)

Mutual funds can also levy pretty large fees. And while they may vary depending on how the fee structure is laid out, funds by law can charge a front-end load of up to 8.5%, which can be an enormous drag on profits for years. (To learn more, read *Stop Paying High Mutual Fund Fees*.)

Hedge funds typically charge annual management fees of 1-2% and then retain 20% of the profits an investor earns. According to Barclay Group, a firm that tracks hedge fund costs, the average management fee in 2005 was 1.56%. In that same year, the average performance fee was 19.6%. Some hedge fund managers charge even more for their services.

In any case, the trick is to figure out whether these fees are truly worth it. In some cases, a firm that charges high fees might also generate very high returns for its investors. However, this is not always so, and in most cases, high fees just erode investors' returns. (For related reading, see *Benchmark*

Your Returns With Indexes.)

Investment Horizon
Because ETFs are traded on the major stock exchanges and the transaction fees are generally inexpensive, an investor can trade in and out of them with relative ease. However, mutual funds, because they often contain redemption fees, and/or large front-end loads, are usually considered longer-term investments. (For related reading, see *When To Sell A Mutual Fund*.)

Hedge funds are also considered to be longer term investments because redemptions are typically only allowed in certain quarters - and sometimes only with advanced written notice. In fact, some hedge funds have extended multi-year lock up periods.

When looking for the right investment, investors must realize the advantages and limitations of each investment vehicle prior to becoming involved.

Risk Tolerance/Hand Holding
In many cases ETFs track or mimic major indexes, such as the S&P 500. While risk is certainly an issue, these broad-based investments are generally considered less volatile than other investment vehicles. To be clear, some mutual funds are also constructed to diversify away risk, as they too invest in or mimic broad indexes. However, many mutual funds are also actively managed and often highly concentrated in one particular sector. This can increase investment risk. (For more insight, read *Words From The Wise On Active Management*.)

Hedge funds are considered among the riskiest investment vehicles because a hedge fund may go long or short and purchase a variety of hybrid investments in an effort to beat the market. In addition, some hedge funds use options or other derivatives to purchase or control large amounts of stocks in the hope of achieving superior returns. This, too, can dramatically increase a fund's risk profile. (To learn more, read *Hedge Fund Failures Illuminate Leverage Pitfalls*.)

As evidence of just how risky hedge funds can be, one need only look at Amaranth Advisors. In 2006, the fund is said to have leveraged its holdings by as much as 8:1 in order to place a large bet on the direction of futures contracts. The contract price moved against Amaranth and losses are said to have topped $6 billion. Prior to the debacle, the fund's total assets were reportedly just over $9 billion.

Hand Holding
Many money managers and investment advisors will take phone calls and discuss strategy with their investors. However, with ETFs, there is generally no hand-holding. While hedge fund managers may take your phone call, they typically won't discuss their positions or their proprietary trading systems they use. In addition, hedge fund managers assume that their clients, because of the qualifications necessary to open an account, are more sophisticated and generally more risk-averse than a typical retail investor. (For related reading, see *Hedge Funds Go Retail*.)

Directing Investment Decisions
If you want to have some control over your investments, consider an ETF or invest with an advisory firm. With mutual funds, it is not possible to control the individual stocks or bonds that are actually owned within the portfolio. This may be a problem for environmentally conscious investors or others that want strict control over their holdings.

With that in mind, hedge funds investors have perhaps the least control over their holdings. Hedge fund managers frequently dart in and out of investments, often on short notice, in an effort to beat the market. In addition, hedge fund managers are highly protective of their trading methods and strategies, and for that reason, investors and the public at large are usually only aware that a fund has bought or sold a stock after the transaction has been completed.

Bottom Line
There is no pat answer for what type of investment is better, ETFs, mutual funds, hedge funds or advisory firms. Therefore, investors must weight their options carefully and consider their individual circumstances to choose the most suitable option.

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Glenn Curtis started his career as an equity analyst at Cantone Research, a New Jersey−based regional brokerage firm. He has since worked as an equity analyst and a financial writer at a number of print/web publications and brokerage firms including *Registered Representative Magazine*, *Advanced Trading Magazine*, Worldlyinvestor.com, RealMoney.com, TheStreet.com and Prudential Securities. Curtis has also held Series 6,7,24 and 63 securities licenses.

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