

EXPENSES IN A DOWNTURN

Examining the effect on fund expenses due to the decline in fund assets during the 2008 bear market

JANUARY 2009

INTRODUCTION:

The 2008 market downturn has taken a substantial toll on mutual fund assets. With this asset decline, we have witnessed growing concern amongst fund boards and advisors in regard to expense comparability and the applicability of peer groups. Lipper publishes expense data for funds based upon each fund's most recently reported, audited annual report; however, given the timing of the fiscal year-ends for most funds (50% of funds have fiscal year-ends of October 31, November 30, or December 31—annual reports are typically filed 60 days after a fund's fiscal year-end), annual reports either have not yet been published or do not yet reflect the reduction in assets. These annual reports, even after they become available, will represent only a partial year of operating history at the lower asset levels, as industry asset levels experienced their largest decreases during the fourth quarter of 2008.

While expense run-rates (current expenses ratios at existing assets) are typically available to board members and asset managers for their own funds, current expense run-rates for peer funds are not publicly available, creating unique challenges for peer comparisons. This document attempts to help boards understand many of the issues currently facing the industry and make decisions based on the limited information available.

ECONOMIES OF SCALE

Prior Lipper research has demonstrated that there is a perceived level of economies of scale with respect to fund expenses.¹ Mutual fund expenses typically consist of both variable and fixed expense components. As the assets of the funds increase, these fixed costs are distributed over a larger asset base, reducing the total expenses paid on each dollar invested in the funds.

Many funds also utilize breakpoints in their management fee schedules, whereby the management fee on incremental assets is reduced once the fund surpasses a predetermined asset level. This means that as asset levels contract, funds could potentially move out of the breakpoint levels that they had previously surpassed, causing management fees, as a percentage of assets, to increase.

As economies of scale have been shown to exist in the industry, it is reasonable to expect that expenses, on average, will decline with an *increase* in industry assets, and increase with a *decline* in industry assets.

¹ "Management Fee Benchmarking Guide - The Unparalleled Guide to Management Fee Benchmarking" January 2006.

KEY POINTS:

- During the 2008 downturn, equity funds have realized the largest decline in assets in recent history over a relatively short period of time.
- The existence of economies of scale will typically cause expense ratios to increase, on average, when fund assets decrease substantially.
- Fund expense ratios have been trending downward for many years.
- During the 2001 downturn, despite a large decrease in assets, actual expense ratios were affected only minimally. The downward expense trend actually increased for a majority of funds.
- During the 2001 market downturn, medium-sized funds experienced an increase in fund expenses. This was not the case for small, and very large funds.
- For funds that have recently published a new prospectus, it appears that most fund complexes have not been revising expenses upward as a result of the decline in assets.
- Lipper believes that peer group analysis remains an important tool for fund boards to utilize when evaluating fees. Peer groups should always be examined in conjunction with other data.
- Although it is likely that expense ratios for some funds will increase as a result of the reduction in fund assets, actual fiscal data is not yet available to verify this. Lipper intends to publish a final 2008 expense analysis once all 2008 fiscal data is publicly available.

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DECLINE IN INDUSTRY ASSETS

DECLINES BY ASSET-CLASS

First we will address the 2008 fund industry downturn (defined hereafter as the period from October 31, 2007, to November 30, 2008) in the context of the most recent period where the fund industry experienced a significant decline in assets. The last time the industry experienced a decline of similar magnitude was during the period from March 31, 2001, to March 31, 2003 (2001 downturn). Note that the 2008 market downturn is defined primarily by the decline in equity fund assets, as opposed to industry assets as a whole. Equity assets peaked in October 2007, while money market fund assets have continued to rise each month. Fixed income fund assets peaked during August 31, 2008 (Figures 1-4).

During the 2001 downturn, United States Diversified Equity (USDE) same-fund assets declined by 26% from March 31, 2001, to March 31, 2003, on average. During the 2008 downturn, USDE same-fund assets declined by roughly 41%, a substantially greater asset drop than during the 2001 downturn. Same-fund assets are the assets of funds that existed both at the beginning of the period and remained in existence at the end of the period. This analysis removes the effect of any funds that were liquidated or were merged into another fund or any new funds that were released during the period. The 2001 downturn took a longer time to develop than the current drop, allowing a longer time to assess the effects on fund expenses; however, given that the 2001 downturn was relatively recent and many of the mutual funds that existed in 2001 are still active today, we feel that it is appropriate to use the expense changes that occurred during the 2001 downturn as a proxy for what is likely to happen to fund expenses subsequent to the 2008 downturn.

Figures 1, 2, 3, and 4 display the month-end total net assets for each asset class since December 31, 2006. The green arrow in each figure shows the month where assets reached their highest point, while the red arrow illustrates the month where assets were at their lowest point. All values are in \$trillions.

FIGURE 1 NET ASSETS BY MONTH—ALL FUNDS (\$Tril)

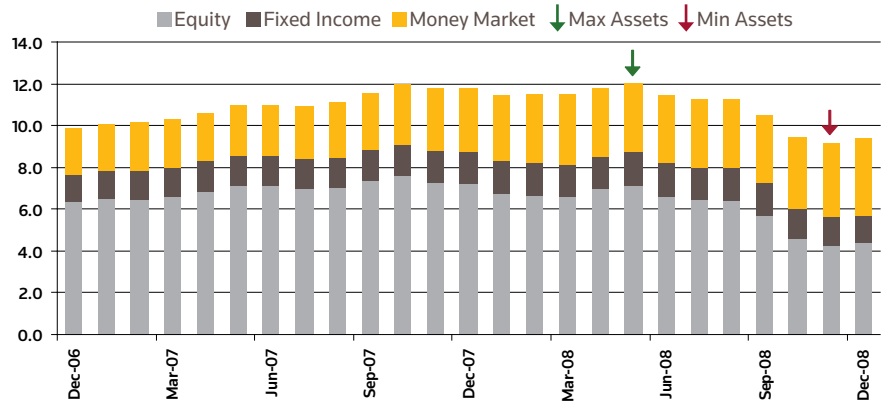


FIGURE 2 NET ASSETS BY MONTH—EQUITY FUNDS (\$Tril)

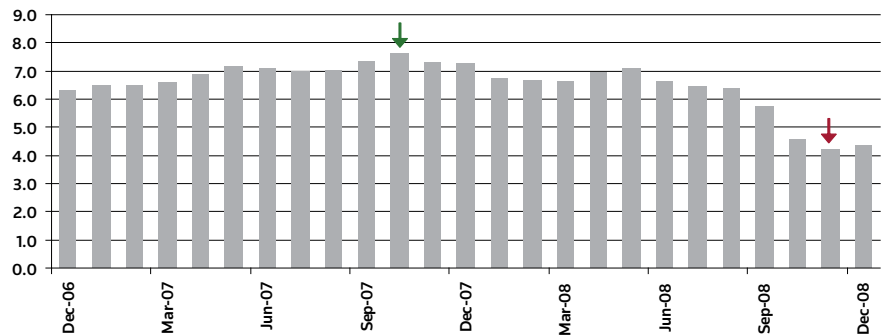


FIGURE 3 NET ASSETS BY MONTH—FIXED INCOME FUNDS (\$Tril)

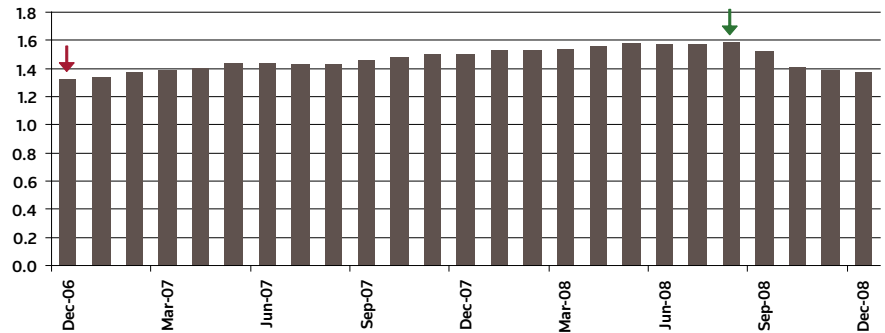
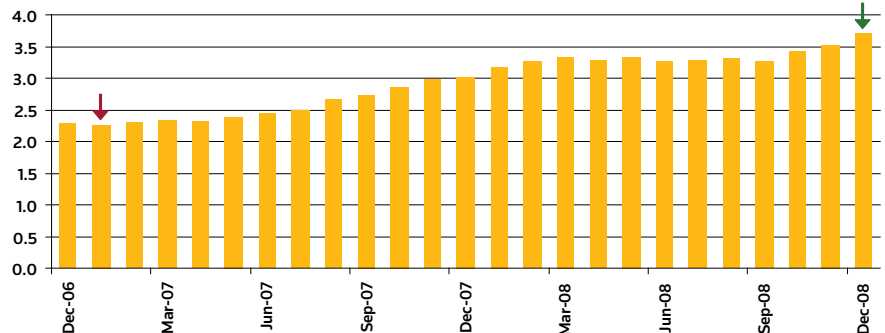


FIGURE 4 NET ASSETS BY MONTH—MONEY MARKET FUNDS (\$Tril)



EXPENSE TRENDS

We note that fund expenses have been trending downward for years. On an asset-weighted average basis, actively-managed USDE total expense ratios declined from 1.059% in 2002 to 0.924% in 2007, a decline of 13.5 basis points in just five years. When examining all actively-managed mutual funds, rather than just the USDE asset class, asset-weighted total expense ratios declined by only 4.3 basis points from 0.791% to 0.748%. However, this smaller decline is largely the result of shifts in investor dollars between asset classes. For example, the relatively high-expense world equity asset class made up only 6% of industry assets in 2002. By 2007, however, the asset class represented 13% of industry assets. Although expense ratios for world equity funds declined dramatically during this period (-14.6 basis points), the greater influence of these funds in 2007 helped to keep industry-wide expense ratios propped up.

During 2007, investors held more equity assets (52%) than fixed income and money market assets (42%); however, in 2002, the majority of fund industry assets were held in fixed income and money market funds (52%). Because fixed income funds, on average, have lower total expense ratios than equity funds, this shift in assets

helped to stabilize industry expense ratios as a whole. As expenses for both equity and fixed income funds dropped, the downward effect of overall expense ratios was constrained because industry assets were moving out of fixed income and into the relatively more expensive equity classifications.

There were no fund asset classes that experienced an increase in total expense ratios over this time period. Expense declines ranged from the Gold and Specialty Diversified Equity classifications, each at -37 bps to the Other World Equity asset class at -1 bp (the Other World Equity classification includes Lipper's emerging markets and regional world equity classifications).

As future investor asset class preferences are unknown, it would not be appropriate for us to examine the expense ratios of the industry as a whole. Rather, asset changes and expenses should be examined within their respective asset classes.

TABLE 1 HISTORICAL EXPENSE TRENDS

	2002 Fiscal Year		2007 Fiscal Year	
	TER	% of Assets	TER	% of Assets
All Actively Managed Funds	0.791	100.0%	0.748	100.0%
All Equity	1.068	48.1%	0.937	58.4%
All USDE	1.059	32.3%	0.924	32.1%
Large-Cap	1.002	18.4%	0.817	13.9%
Multi-Cap	1.049	8.2%	0.916	10.2%
Mid-Cap	1.222	3.3%	1.086	4.5%
Small-Cap	1.307	2.4%	1.161	3.5%
Balanced Mixed Equity	0.898	5.1%	0.802	8.2%
Other Domestic Equity	0.951	1.7%	0.940	2.4%
Equity Income	0.936	1.6%	0.892	1.9%
Specialty Diversified	1.490	0.0%	1.125	0.5%
Sector Equity	1.312	2.6%	1.030	2.6%
All World Equity	1.182	6.4%	1.036	13.0%
Global	1.157	2.3%	0.979	3.0%
International	1.169	3.3%	0.996	7.8%
Gold	1.405	0.0%	1.033	0.2%
Other World Equity	1.296	0.8%	1.286	2.0%
All Fixed Income	0.535	51.9%	0.481	41.6%
All Taxable Fixed Income (ex MM)	0.792	9.5%	0.674	10.5%
All Domestic Taxable Fixed Income	0.785	9.2%	0.665	9.8%
Short/Intermediate Taxable Fixed Income	0.632	4.3%	0.527	5.2%
Long Taxable Fixed Income	0.920	4.9%	0.820	4.6%
World Taxable Fixed Income	1.004	0.3%	0.816	0.7%
All Money Market	0.447	36.8%	0.383	26.9%
Taxable Money Market Funds	0.442	32.3%	0.383	22.7%
Tax-Exempt Money Market Funds	0.482	4.5%	0.382	4.2%
All Municipal Debt	0.676	5.5%	0.633	4.1%
Short/Intermediate Municipal Debt	0.503	1.3%	0.482	1.1%
Long Municipal Debt	0.732	4.1%	0.691	3.0%

Table 1 displays the historical total expense ratios and asset allocations between various asset classes. All expense numbers reflect asset-weighted averages. The data represents all open-end funds in the Lipper database in each grouping.

PREVIOUS EXPENSES AT SIMILAR INDUSTRY ASSETS

The last time that total assets in equity funds were at current levels (roughly \$4 trillion) was in late 2004. We examined the historical 2004 fiscal data in the Lipper database to determine the expenses of equity funds at this industry-wide asset level.

On an asset-weighted average basis, expense ratios for funds with annual reports published in 2004 were 9.1 basis points higher than they were in 2007 and 12.6 bps higher on a median basis. Expenses were higher by a similar amount for USDE funds, specifically.

However, we believe that it is unlikely that 2008 expense ratios will revert to 2004 levels, despite similar asset levels. There are factors in addition to industry assets that have influenced the downward trend on fund expenses including increasing investor demand for lower-cost funds, and increased regulatory scrutiny.

TABLE 2 EXPENSE RATIOS AT 2004 ASSET LEVELS VS. 2007

	2004 Expenses		2007 Expenses	
	Asset-Weighted		Asset-Weighted	
	Average	Median	Average	Median
All Equity Funds	1.028	1.529	0.937	1.403
All USDE Funds	1.016	1.472	0.924	1.342

EXPENSE ANALYSIS DURING THE 2001 MARKET DOWNTURN

We analyzed all USDE funds that existed on March 31, 2001, and remained in existence as of March 31, 2003, to identify any expense trends over this time period.

Interestingly, although the assets in this asset class declined by 26% over the two-year period, this trend was not constant among funds of all sizes. On average, larger funds exhibited substantially larger asset declines than smaller funds. Funds that had total net assets under \$250 million as of March 31, 2001, actually gained 8% in assets during the period, while funds with greater than \$10 billion lost 32%. On average, larger funds lost more assets than smaller funds (Figure 5).

This trend has not repeated itself thus far into the 2008 downturn, however. While funds under \$250 million as of October 31, 2007, still experienced the smallest decline in assets, relative to funds of other sizes, funds of all asset sizes, on average, experienced asset declines of 37% or more. There is little evidence that smaller funds have fared better than larger funds as was clearly the case during the 2001 downturn (Figure 6).

On an asset-weighted average basis, there was a small increase in total expense ratios during the 2001 market downturn; however, management expenses for the same group of funds were unchanged on an asset-weighted basis. Like the asset declines discussed above, these changes were not constant among funds of different sizes. The total expenses of funds with assets between \$750 million and \$10 billion increased 5–7 basis points on average (Figure 7). Funds in the largest group (greater than \$10 billion) and funds with assets below \$750 million were largely unchanged. The phenomenon can be explained to some degree by observing that smaller funds tend to have total expense ratios that are subject to expense caps. As assets decrease, the funds may be contractually obligated to waive management expenses in order to keep expenses under the expense cap. This effect can also be seen in the lower management expenses that the

FIGURE 5 ASSET DECLINES BY FUND SIZE—2001 DOWNTURN

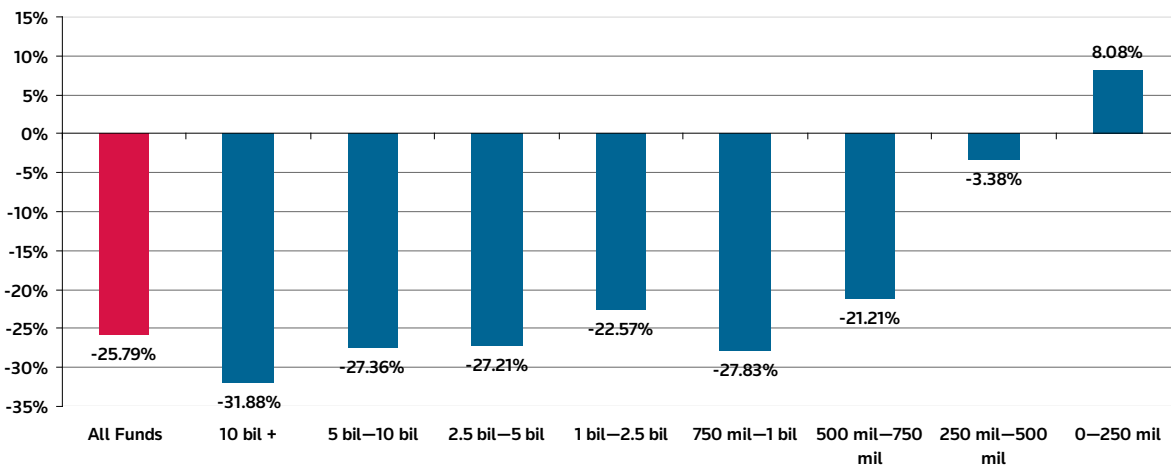
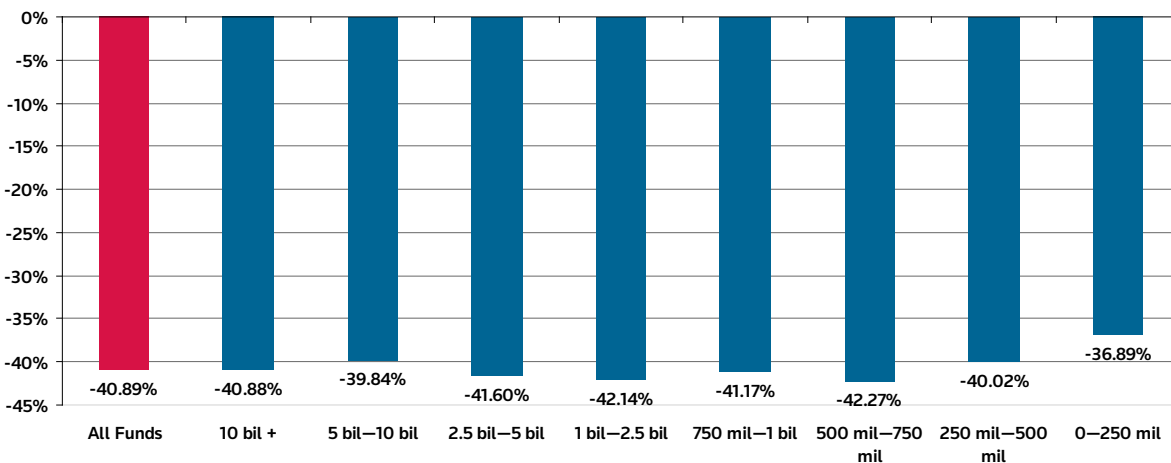


FIGURE 6 ASSET DECLINES BY FUND SIZE—2008 DOWNTURN



Figures 5 and 6 display the asset declines that were realized by funds of different initial asset sizes during the 2001 downturn and through November 30 of the 2008 downturn.

FIGURE 7 EXPENSE CHANGES BY FUND SIZE—2001 DOWNTURN

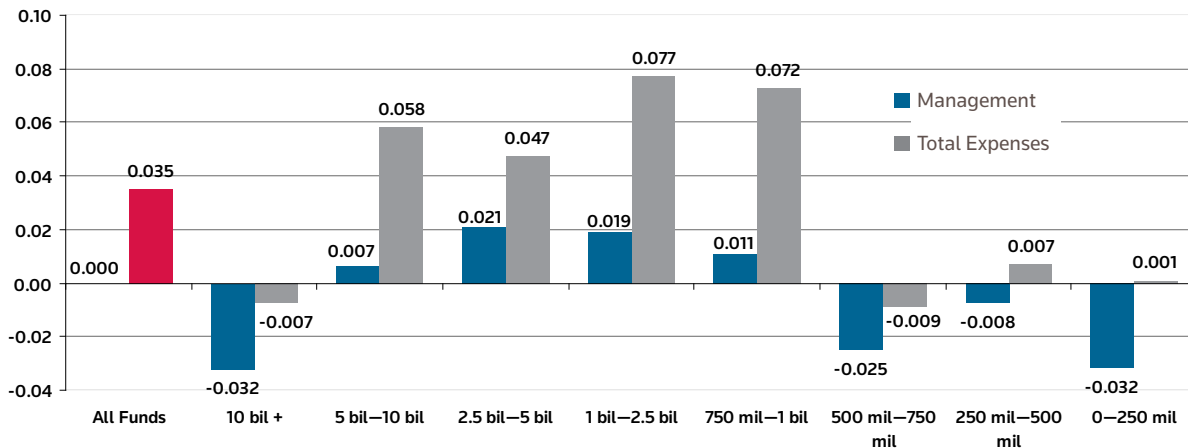


Figure 7 illustrates asset-weighted expense ratio changes during the 2001 downturn. Total expenses are shown in gray while management expenses are shown in blue. All funds, regardless of asset size are shown to the far left in red. Both the largest and smallest funds exhibited a decrease in expense ratios while for medium-sized funds, expense ratios increased, on average.

funds paid. Management fee waivers did, in fact, increase for these funds as well, primarily amongst the funds with assets under \$250 million where asset-weighted management fee waivers increased by 1.2 basis points.

The reason that the group that includes the largest funds (greater than \$10 billion in assets) exhibited a slight decrease in expenses despite posting the largest decline in assets is less clear. We hypothesize that many funds in this group have reached potential economies of scale in their operations. It may be the case that funds of this size were better able to control their expense levels despite the fact that this group experienced the greatest decrease in assets. The industry trend of decreasing expense ratios was maintained among this group.

Although, on an asset-weighted average basis, total expenses increased during the period from March 2001 to March 2003, a majority of the USDE funds in the Lipper database experienced a decrease in expense ratios over the period. As of March 2003, 71% of the funds had a total expense ratio that either decreased or remained constant; 63% of the funds experienced either a decreasing or constant management fee over the same period (Figure 8). This data indicates that the decrease in assets during the 2001 fund industry downturn did not directly affect the expense ratios of the majority of funds. In fact, the trend of decreasing expense ratios continued in spite of the reduction in assets.

SIMILARITIES TO 2008 DOWNTURN

During the 2008 industry downturn, we have seen fund asset levels drop substantially more than during the 2001 downturn (USDE assets declined roughly 41% in 2008, relative to only 26% during the 2001 downturn). Additionally, we have not observed the stratification of the effects among funds of different sizes. As mentioned above, there is little evidence the smaller funds experienced much less of a decline than their larger counterparts.

As previously stated, the 2008 downturn unfolded over a shorter time-frame than the 2001 downturn. The 2001 downturn took two years to bottom-out, while funds experienced a greater decrease in assets in only one year of the 2008 downturn. Assuming that the 2008 downturn has reached its bottom, funds lost 50% more assets in half of the time as compared to the 2001 downturn.

MARKET BENCHMARK PERFORMANCE

During the 2001 fund industry downturn (March 31, 2001, to March 31, 2003), the S&P 500 Index posted a negative return of 24.58%, while the total market Russell 3000 posted a decline of 23.33%. During the 2008 downturn, through November 30, the S&P 500 had lost over 40.68%, with the Russell 3000 posting a loss of 41.61%.

This data indicates that the severity of the 2008 downturn has been greater than the previous downturn in 2001. Interestingly, the declines in the market benchmarks above were very similar to the total decline in USDE fund assets during each of the downturns (26% and 41% for the 2001 and 2008 fund market downturns, respectively).

FIGURE 8 FUNDS WITH CONSTANT OR DECLINING EXPENSES—2001 DOWNTURN

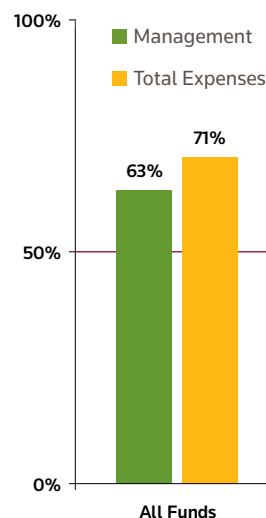


Figure 8 illustrates the percentage of funds for which total expenses either declined or remained the same despite the drop in assets during the 2001 downturn.

FEASIBILITY—LACK OF DATA FOR COMPARISON

Since fiscal expense data currently available for the majority of funds reflects the funds' expenses for periods prior to most of the 2008 downturn, it is unlikely that audited annual report numbers will accurately depict current expense environments for the funds. Audited reports that will be released in the next several months will reflect only a partial year of operating history at these lower asset levels. In an environment where expense ratios are increasing, published annual report numbers will represent the average expense run-rate for the period, rather than the run-rate at the start of the period (which will be lower than the annual report numbers), or the run-rate at the end of the period (which will be higher).

While fund advisors are typically able to provide their boards with current expense run-rates for their own funds, current run-rates for peer funds are not publicly available. This creates a potential lack of comparability between current run-rates and audited fiscal numbers.

In any market condition, there are normally some challenges in comparing the funds in a peer group, if only for the difference in the timing of the annual reports. Two funds in a peer group could reflect data that is a year apart or more. In a market where assets are increasing, the fund with the earlier fiscal data is inherently at a disadvantage to the fund with the later fiscal year-end. However, Lipper chooses to err to the side of conservatism and use only audited expense data that has been filed with the SEC for each fund.

CHANGES IN PROSPECTUS EXPENSE RATIOS

Although audited annual reports that accurately depict expense changes as a result of the 2008 market downturn will not be available in the near future for most funds, total expense estimates are published in each fund's prospectus. We can evaluate changes to these numbers as new prospectuses are released. We note that there is little evidence of consistency between various fund complexes on what numbers are reported in the prospectus.

SEC Form N-1A states:²

If there have been any changes in "Annual Fund Operating Expenses" that would materially affect the information disclosed in the table:

(A) Restate the expense information using the current fees as if they had been in effect during the previous fiscal year; and

(B) In a footnote to the table, disclose that the expense information in the table has been restated to reflect current fees.

A change in "Annual Fund Operating Expenses" means either an increase or a decrease in expenses that occurred during the most recent fiscal year or that is expected to occur during the current fiscal year. A change in "Annual Fund Operating Expenses" does not include a decrease in operating expenses as a percentage of assets due to economies of scale or breakpoints in a fee arrangement resulting from an increase in the Fund's assets.

² <http://www.sec.gov/about/forms/formn-1a.pdf>

FIGURE 9 PROSPECTUS EXPENSE RATIO CHANGES

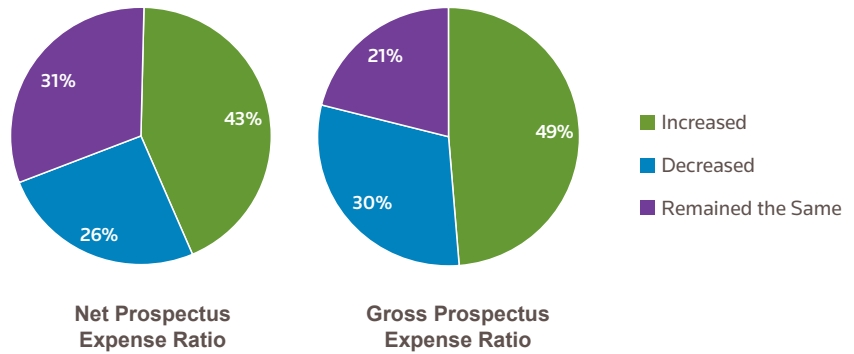
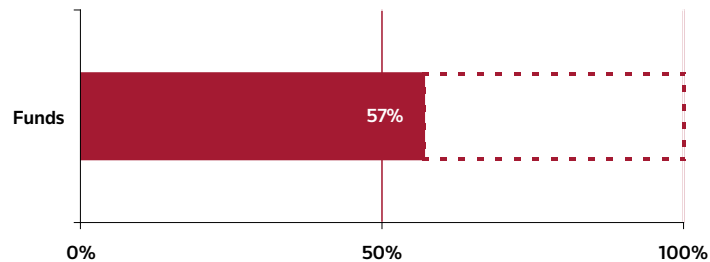


FIGURE 10 FUNDS WITH DECREASING OR CONSTANT NET PROSPECTUS EXPENSE RATIOS



Figures 9 and 10 display the changes in net and gross total expense ratios as reported in the most recent prospectuses for the approximately 1,200 equity funds that have published a new prospectus after November 30, 2008. For a majority of the funds, expense ratios did not increase.

To date, there have been approximately 1,200 equity funds (including all share classes) that have published a prospectus after November 30, 2008. For each of these funds, we compared the newly published net and gross expense ratios to the net and gross ratios that were listed in each fund's prior prospectus. Figures 9 and 10 illustrate the results of this analysis. While a large number of equity funds (43%) published a higher net expense ratio in their most recent prospectus, a larger number (57%) reported a number that was either lower—or the same as—the ratios from the prior prospectus.

In aggregate, there was no change in average net prospectus expense ratios. For the funds that reported an increase in expenses, the average reported increase was 7bps. For funds that reported a decrease in expenses; the average decrease was 11bps.

With respect to gross expense ratios, a greater number of funds reported an increase in expenses than they did for net expenses. This indicates that we are likely to see management fee waivers increase for many funds. For all of the 1,200 equity funds that recently released prospectuses, the average change in gross expenses from the prior prospectus to the most recent prospectus was +11bps.

When we examine all funds that have recently released a new prospectus (including all equity, fixed income, and money market funds—about 1,700 funds, including share classes), the number of funds reporting increases in net expenses declines to only 40% and the number of funds reporting an increase in gross expenses declines to only 44%. This is consistent with what we would expect because fixed income funds did not lose assets to the same extent that equity funds did, and money market funds actually gained assets during the 2008 downturn.

In Lipper's discussions with industry participants and regulators regarding SEC form N-1A, we note that there are multiple interpretations. Although form SEC Form N-1A does not explicitly address an *increase* in expense ratios as a result of a substantial *decrease* in assets, it appears that most fund companies have not been adjusting their prospectus ratios as a result of the recent decrease in assets.

BOARD MEMBER CONSIDERATIONS

The next several paragraphs discuss some of the issues that boards should consider during their 2009 advisory contract renewal process. It is intended to inform board members about some of the challenges that will exist during 2009.

PEER GROUP SELECTION

After considering the limited data that is currently available on the topic, Lipper believes that peer group analysis remains an appropriate tool for fund boards to use in their contract renewal considerations. Lipper peer groups have been consistently utilized for 15(c) contract renewal for over 22 years. Over that time, we have witnessed numerous bear and bull markets where funds have either gained or lost assets in a brief period.

The Lipper 15(c) peer selection process results in a hand-selected group of peer funds (expense group) for each subject fund. While asset-size comparability is included in our selection criteria, it is not the only factor that is taken into consideration when selecting peers. The criteria used are very robust and are designed to determine a group of funds for which, all other things being equal, we would expect to be similar from an expense perspective.

While the expense group analysis is one of the primary components of Lipper 15(c) reports, Lipper believes that a peer group should not be examined in isolation. Most Lipper 15(c) reports include an expense universe in addition to the hand-selected expense group. The Expense Universe includes all funds in a given Lipper investment classification with the same load-type as the subject fund, regardless of asset size, excluding certain outliers. It can be viewed largely as an extension of the expense group with no asset-size restrictions. An example of how a board might utilize both groups is described below:

Fund ABC is a very large multi-cap growth equity fund and its expenses are very similar to the norm for its expense group, which consists of 12 additional multi-cap growth equity funds of similar size to Fund ABC. Relative to the funds in the expense universe, which consists of all 236 multi-cap growth equity funds, excluding outliers, Fund ABC's expenses are below the universe average. This indicates that funds in the Lipper classification tend to benefit from perceived economies of scale and the larger funds in the classification have lower expenses, on average, than smaller funds.

While the Lipper report will show the funds at their average run-rates for their last fiscal year, it would be reasonable for a board to consider the expenses of the funds in the expense universe in addition to the expenses of the funds in the expense group. If Fund ABC has dropped from \$1 billion in assets to \$500 million, it may be reasonable to expect that the fund's expenses, going forward, would be similar to some of the smaller fund's in the expense universe. It is important to note, however, that funds in the expense group are likely experiencing declining assets as well as the ABC Fund.

DATA NORMALIZATION

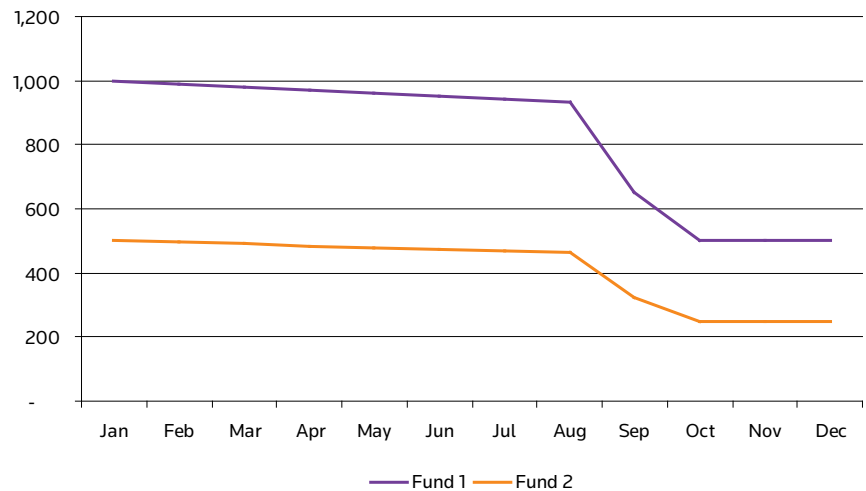
Lipper recommends the use of audited fiscal data from each fund's annual report in the 15(c) process. Lipper believes that attempts to normalize the data may yield results that are less accurate than using verifiable, audited financial data for peer funds as there are many variables that could potentially influence any attempt at normalization. Boards should not ignore the fact that assets have declined substantially; rather they should be aware of current limitations and make decisions accordingly. It may be prudent for boards to request updated expense data for peer funds once it becomes available.

EXPENSE CAPS

Boards should also note that current expense caps may need to be examined for funds where assets have declined considerably. If a fund's expenses have increased materially as a result of a drop in assets, previous expense cap levels may no longer be equitable. Again, an examination of expense caps might begin with a review of the Lipper expense universe to determine fee levels in a given investment classification, regardless of their asset size.

MANAGEMENT FEES

Many Lipper 15(c) reports include a chart that describes contractual management fees at various asset levels. This chart is designed to compare the contractual management fees of a given fund to the fees that are charged by other funds in the same Lipper investment classification at hypothetical asset levels. This chart helps boards to determine the prevalence of management fee breakpoints in the classification. Boards can use this data to see how their funds will compare to peers at a lower asset base. It is important to note, however, that these effective management fees do not include the effects of any fee waivers or reimbursements, meaning the board must again base their decisions on multiple pieces of data.

FIGURE 10 ASSETS OF TWO HYPOTHETICAL FUNDS (2008)**NONMANAGEMENT EXPENSES**

Nonmanagement expense components are more challenging from the perspective of peer comparison. Many of these expenses are driven by the average size of investor accounts, rather than the size of the fund as a whole. Expenses that are incurred for each shareholder account will likely increase substantially, on an asset-weighted basis, in an environment where assets are rapidly declining. It is difficult to assess a fund's comparability to peers when individual account-based charges are not known.

Figure 10 helps to illustrate some of these challenges using two hypothetical funds. Fund 1 began 2008 with \$1 billion in assets, while Fund 2 began the year with only \$500 million. Through the course of the year, specifically during September and October, the assets of Fund 1 declined to the asset level where Fund 2 began the year.

If Fund 1 retained most of its shareholder accounts, then it is reasonable to assume that the average account is roughly half of the size at the end of year than it was at the beginning of the year. Expenses that are driven primarily by the number of shareholder accounts such as transfer agency expenses, printing, and postage costs will be substantially higher for Fund 1 at the end of the year.

For this reason, it would not be entirely appropriate for fund boards to assume that the expenses of a fund that has dropped from \$1 billion in assets to \$500 million will have expense run-rates that will be similar to the known fiscal expense ratios of funds that began the year with \$500 million in assets. As average account sizes will have dropped considerably, the current expense run-rates of Fund 1 may be very dissimilar the historical expenses of Fund 2.

CONCLUSION

After considering all possible options, Lipper believes that it would be appropriate, in most cases, for boards to compare the audited expenses for their funds to the audited expense ratios for their peer funds, although boards should be aware of how current expense run-rates compare to audited fiscal numbers. It may be the case that as assets have dropped, current expenses may be higher than the audited fiscal numbers from the annual report. It is also likely that peer funds are experiencing similar operating conditions and are subject to similar changes in expense ratios.

Surprisingly, the drop in assets during the 2001 downturn (while smaller than the drop during the 2008 downturn) did not have a substantial effect on fund expense ratios. Although we would have expected expense ratios to increase substantially during this period, expense level increases were relatively minor and the majority of funds actually decreased their expenses during this period. Until expense data for 2008 is available for all funds, it is impossible to judge the true effect of the recent market downturn on fund expenses. Lipper plans to release a final 2008 expense analysis once all 2008 fiscal expense data is publicly available.

We note that in prospectuses that have been released in the past several months, it does not appear that many fund complexes have been adjusting their prospectus expense ratios as a result of the decline in assets.

Lipper believes that peer group analysis remains one of the most valuable tools available to boards in the evaluation of fund fees and expenses. While the substantial decline in industry assets during the fourth quarter of 2008 creates unique challenges in terms of the comparability of costs between funds, we believe that the peer group should still be used as a starting point for board discussions regarding fees and expenses.

LOOK FOR UPCOMING LIPPER FIDUCIARY RESEARCH RELATED TO FUND EXPENSES, EXPENSE CAPS, AND HOW FUND COMPANIES ARE MANAGING EXPENSES IN THIS PERIOD OF DECLINING ASSETS.