N. Lee
Kelly

JAMES A. RHODES
GOVERNOR

J. GORDON PELTIER
DIRECTOR OF COMMERCE

State of Ohio
Department of Commerce
Division of Securities
Columbus 43215

417 OHIO DEPARTMENTS BUILDING

BENSON L. OWENS
COMMISSIONER OF SECURITIES

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DEC 2 - 1966

U. S. SECURITIES & EXCHANGE COMMISSION

November 30, 1966.

Securities and Exchange Commission,
500 North Capitol Street, N. W.,
Washington, D. C. 20549

Re: Investment Company Act of 1940.

Gentlemen:

I regret that I do not have the name of the party to whom this letter should be addressed. This Division of Securities has pending before it several applications to register mutual fund shares of issuers who represent a recent development in the ordinary investment concept of mutual fund companies. I have reference to those companies who have provided a form of incentive compensation to the investment advisor generally related on a basis of fund performance versus the Dow-Jones average of 30 industrial securities. I understand further that your commission is engaged in a study of the industry but do not know whether its scope extends to this problem.

It appears further that in order to meet or beat Dow performance, the investment advisor may be constrained to acquire widely fluctuating securities especially near the end of the investment year. The situation as a whole appears to create a substantial departure from the basic concept that mutual funds were for the little investor who could not as individuals afford professional advice and who should not be in highly speculative situations. In addition, there is a question whether the selling dealer may not be losing its independence in pushing the trading funds because such portfolio activity generates volume of portfolio purchase and sell orders to be parceled out as a reward to such dealer. On the other hand, the traditional type fund may find that its sales are dropping off and must choose to join the trend "if it can't lick 'em". Such pressure develops among the sales personnel who have to meet the situation in the field if the stable does not make available a competitive fund.

Perhaps the answer lies in requiring a caveat on the frontispiece of the prospectus identifying the type of fund which intends to play market swings rather than have the descriptive statement appear only and buried in the paragraph dealing with investment objectives. Precedent for a caveat has been had in the case of long term capital growth objectives being deemed inappropriate for investors contemplating automatic withdrawal plans.

If the trend (and that is an important word at this time) is to nurture high flexibility in the investment objective by playing market swings, is not the next natural step to begin going short, and when that happens, I believe that we have seen the last of the type of mutual fund investing which has created the public trust and confidence to the tune of many billions of dollars invested by that public. Of course, it is hard to argue with success as some of this type of fund seems to demonstrate thus far but it would seem that the public should be cautioned adequately that a new day has dawned. At this time my observations may appear feeble since only time will prove their validity but it seems that the image of the conservative and professional type of investment advisor is about to disappear from the scene. Included in such observation is the point whether the Dow or other stock index is a valid basis for comparison of performance since such indices are not managed portfolios and at many times during an investment year such blue chip securities are not an investment bargain, at least insofar as a price-earnings ratio is concerned. At least one or two funds have realized the ineptness of such an investment standard by limiting the size of the portfolio beyond which further growth begins to match more and more any such index since the portfolio tends to become the average itself. Thus the trend would appear to contemplate formation of multiple funds having a maximum growth level beyond which public sale will be discontinued. The result thereof would be to deprive the investor of the benefit of a lower expense to income ratio and so dilute his income potential.

It would seem that the picture here has to be considered as a whole rather than considering separate factors by themselves. I am certain that the views expressed above are not unknown to your staff. Would you kindly put us on your mailing list as to any release that we understand is more or less imminent and which may have a bearing on the subject. I should like to state that the views above are my personal views and not those of this Division of Securities. Thanking you for your attention, I remain,

Very truly yours,

N. J. Kiraly

N. J. KIRALY,
DEPUTY COMMISSIONER OF SECURITIES.

NJK/DF