

Understanding managed accounts

If you have a significant sum to invest — generally \$100,000 or more — you can now take advantage of an investment vehicle that once was available only to the very wealthy and to institutional investors. The investment is a managed account. It allows you to tap the expertise of a large, experienced money management firm while still investing through a portfolio that is tailored to your unique needs.

By the numbers

Assets of managed accounts are expected to grow to **\$718 billion** in 2005 (from **\$576.1 billion** in 2004) and to surpass **\$1 trillion** by 2007, according to the Financial Research Corporation, a market research group in Boston.

Source: *The New York Times*, February 13, 2005

What is a managed account?

In a managed account, you obtain all of the benefits that mutual funds offer — professional management, diversification, and liquidity — but unlike a mutual fund, a managed account does not pool your money with other investors' money. All of the securities that the management team selects for the account are owned by you. That individual ownership affords you flexibility, control, and tax benefits that mutual funds and other pooled investment accounts cannot match.

A customized approach to investing

In a managed account, you have some say about what securities are owned in the portfolio. Your input into the buying and selling of securities for your portfolio can include

- excluding certain securities, which you may feel you already own enough of in other portfolios or in your personal investments
- excluding certain securities you have a moral objection to, such as tobacco industry stocks
- incorporating securities you already own into your professionally managed account

How much input you can provide will vary, as each firm that offers these accounts has its own level of customization. While customization affords you greater freedom, it — like

Key points

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Managed accounts offer investors:

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| <ul style="list-style-type: none"> • a personalized investment strategy • more control over individual investments | <ul style="list-style-type: none"> • no sales charges or transaction fees; instead, investors pay an annual asset-based fee | <ul style="list-style-type: none"> • superior service to meet investor goals • professional investment expertise |
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any other freedom — must be used judiciously. Trying to customize the portfolio too much can handcuff the professional managers and hinder their ability to pursue the investment objectives of the account. Your investment professional can help you choose the right separate account manager for you and also help you determine what level of customization will best serve your needs.

One clearly defined objective — yours

In a pooled account, your investment experience can be affected by other investors. In a mutual fund, for example, if a number of investors request redemptions, the portfolio managers may be forced to sell a large stake in a security they like because they need to raise cash to fund the redemptions. In a managed account, other investors' decisions will not affect you because you independently own each of the securities in the portfolio.

Greater tax efficiency

Pooled accounts, such as mutual funds, can create some unwelcome tax consequences. For example, if you purchase a mutual fund just before a capital gain distribution, you could owe a tax on the distribution even though you've owned the fund for only a few days or weeks. That distribution — and your tax — can also be substantial if the fund sold shares of a highly appreciated stock it bought years ago at a low price.

You won't have to worry about this problem in a managed account. The account does not have to make annual capital gain distributions the way mutual funds do. When you first invest in a managed account, your cost basis in any of the shares the portfolio will own on your behalf are based on their value the day you made your investment. Your cost basis in securities subsequently purchased for the portfolio will be their value on the date those securities are purchased.

You will incur capital gains taxes only when individual securities are sold at a gain. You may also have some flexibility in determining how to incur those taxes. For example, if you expect a substantial capital gains tax, you may be able to ask the portfolio manager to incur some capital losses to offset your taxable gain. You also may be able to ask the manager to delay the sale of a security if the delay could potentially shift the gain into the following year or make the profit realized from the sale a long-term gain, which is taxed at a lower rate than short-term gains.

How much a managed account can be managed for tax efficiency varies, again depending on the firm that offers the account. Some firms limit the flexibility account owners are granted with tax decisions because putting too much emphasis on tax issues can adversely affect the account's performance.

Key features

Asset-based fees: With managed accounts, investors pay an annual asset management fee, with the level of the fee determined by the amount of assets in the account. The fee covers the cost of the expertise delivered by your professional adviser and the investment team, and it also pays for the expenses associated with administering and servicing your account. Because the fee is a percentage of the assets of your account, all parties involved with your account have incentive to increase the value of the account as much as possible. That can benefit you as the client. The rewards for continuing to serve your needs are not gone after the initial sale, as can be the case with products that levy an initial sales charge.

Extensive due diligence: All investment professionals must make diligent efforts to understand the products they recommend to clients. The firms that offer managed accounts make extensive efforts to meet these "due diligence" requirements. Firms that market this product — including brokerage firms, financial planning organizations, and financial institutions such as banks — do extensive research before admitting an investment management firm and its particular portfolio managers into their managed account programs. The extensive reviews do not end once a firm has been admitted. The

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sponsoring firms constantly monitor the performance of each investment management team.

Service: While mutual funds issue annual and semiannual reports to update shareholders on holdings and performance, managed accounts typically provide quarterly updates to show all activity in the account and the performance of the account in relation to a benchmark. These updates often include additional information such as market outlooks, commentary from the portfolio manager, and a statement of the tax liabilities the account owner incurred during the quarter. You and your investment professional can also schedule reviews of your account on a more frequent schedule, as you wish.

How your investment professional can help

While the features and benefits of managed accounts may appeal to you, your investment professional, if he or she has not done so already, will want to conduct a thorough analysis of your needs before recommending a particular product. To perform this needs analysis, your investment professional may ask you to complete a questionnaire about your goals, your risk tolerance, and your current financial circumstances. Armed with this

information, your investment professional will have a better understanding of what investment options are right for you. After a thorough evaluation of your needs, your investment professional can help you determine if managed accounts suit your needs.

You also can count on your investment professional to deliver ongoing support. He or she can help you devise an asset allocation strategy to keep your assets diversified across a range of portfolios in different asset classes and with a variety of investment objectives. Working with an investment professional also gives you an expert to turn to whenever you have questions about the financial markets or your investments.

Additional resources

The 24-page miniguide *Your Guide to Managed Accounts* explains the essentials of professionally managed accounts for \$6.95. To order, call Lightbulb Press toll free at 1-800-581-9884, or use its Web site www.lightbulbpress.com.

Contact your investment professional for more information.

Investment return and principal value of both mutual funds and managed account investments will fluctuate, and sale proceeds may be more or less than the amount invested.

A prospectus for any MFS product can be obtained from your investment professional. You should read the prospectus carefully before investing as it contains complete information on the fund's investment objective(s), the risks associated with an investment in the fund, the fees, charges, and expenses involved. These elements, as well as other information contained in the prospectus, should be considered carefully before investing.

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