

FUND TRACK

First the Losses, Now Bond-Fund Lawsuits

Indiana Charity Is Latest To Seek Recourse as Values Of Debt Portfolios Decline

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Online WSJ.com - As the credit crunch is starting to hit some bond mutual-fund investors in unexpected ways, some are now taking legal recourse for losses in their investments.

In the most recent instance, an Indiana charity filed an arbitration complaint against Memphis, Tenn., broker-dealer Morgan Keegan & Co. unit of Regions Financial Corp., for an alleged misrepresentation in selling a bond mutual fund. The fund has lost nearly half of its value this year.

The complaint comes on the heels of a lawsuit filed in a federal court in Manhattan in October over an institutional bond fund of State Street Corp., which alleged that the fund invested in "high risk" investments. A State Street spokeswoman has denied that the firm incorrectly communicated the investment objective of the fund.

In its arbitration complaint, the Indiana Children's Wish Fund says that it invested around \$220,000 in the Regions Morgan Keegan Select Intermediate Bond Fund, on the understanding that it was a relatively safe investment. The complaint was filed with the Financial Industry Regulatory Authority last month.

A Morgan Keegan spokeswoman said via email: "We will respond to the Wish Fund's complaint in due course through the established arbitration process. ... We are confident the arbitration process will result in an appropriate outcome."

The Wish Fund, which grants the wishes of children who are diagnosed with life-threatening illnesses, made the investment based on the recommendation of an agent of Regions Bank who met the Wish Fund's executive director, Terry Ceaser-Hudson, in June this year. According to the complaint, the agent suggested that moving the Wish Fund's money "from a money market account and certificate of deposit investments into his recommended investment was completely safe and a smart business decision."

The Intermediate Bond Fund was hit hard amid the turmoil in the credit markets since this summer, as many of fund's investments in mortgage-backed and other asset-backed securities couldn't find buyers. The fund also had redemptions from investors, which forced the managers to sell in a down market and reduced the value of the portfolio.

The fund is currently down around 45% since the start of the year, the worst performer in the intermediate-term bond-fund category of funds, according to research firm Morningstar Inc. The average fund in this category is up 5% since the start of the year. In late September, the Wish Fund's investment in the Morgan Keegan fund was

liquidated at a loss of approximately \$48,000 or about 22% of the invested money, says the complaint. **"The presentation to the Wish Fund was that this was an appropriate CD alternative, and nothing could be further from the truth," says Thomas Hargett, a partner with Maddox Hargett & Caruso PC in Indianapolis who represents the charity.**

The Intermediate Bond fund's Web site says that it may invest in mortgage and other asset-backed securities, and that it may invest up to 35% of its assets in securities that are below investment-grade. As of Sept. 30, the fund invested 11% of its portfolio in securities rated BB+ or lower. In a letter to shareholders late last month, fund manager Jim Kelsoe said that "we will do our best to navigate the portfolios through these difficult times."

Another fund managed by Mr. Kelsoe, the RMK Select High Income fund, has been the worst performer in the category of high-yield or "junk" bond funds. The fund is down 55% since the start of the year, as opposed to a 1.15% return of the average high-yield bond fund, according to Morningstar.

Meanwhile, in the State Street case, one company sued the firm over the State Street's Intermediate Bond Fund, an institutional fund. The complainant, New York publishing firm Unisystems Inc., said that the fund's managers invested in "high risk" instruments and mortgage-backed securities, while representing the fund as a conservative investment option.

The lawsuit alleges that between July 1 and Sept. 1, the fund declined by 25% in value while the index it "purported to track actually increased."