



**ONE BOY AND
HIS HERO,
A HURLER NAMED BOO**

BY SAM GWYNNE

IS BUYING A BABY SO WRONG? PAGE 2

EASY ONION RINGS. TONIGHT! PAGE 3

THE
BOSTON

Globe

02.19.06 /// MAGAZINE

As Fidelity falters on mutual funds and cuts Boston jobs,
the company's stature as a hometown giant is shrinking.
Is your nest egg still in the best hands?

Losing It

BY KRIS FRIESWICK



LOW FIDELITY

FIDELITY INVESTMENTS TURNS 60 THIS YEAR.

BUT ITS CUSTOMERS MAY NOT BE IN A CELEBRATING MOOD.

As the company has grown and changed, Fidelity's bread and butter - the mutual funds you and I are counting on for retirement - have been outperformed by smaller competitors, leaving the ruling family at a critical juncture and forcing Boston to wonder about the future of one of its last home-grown giants. **BY KRIS FRIESWICK**



IT'S 11:30 A.M. ON A SUNNY, cold Wednesday in Boston. The lunchtime people walk in quick, straight lines through Copley Square under the Romanesque gaze of Trinity Church. They're all in a rush, but I'm stopping them anyway, asking what Fidelity means to them. In this town, I don't need to explain that I mean the company, not faithfulness. Despite the bustle, everyone's happy to chat. That's because almost all of them have more than a passing familiarity with Fidelity Investments, the Boston-based financial-services behemoth celebrating its 60th birthday this year.

Jessica Cogswell, a 20-something single, used to work there. Les, a funky 40-ish software-company sales executive who declined to give his last name because Fidelity is one of his clients, has retirement money invested there. So does 40-year-old Malcolm McDonald, a sharply dressed investment manager. Julie, who also wouldn't give her last name, has a sister who is a Fidelity president. Anita and Robin Lincoln, local philanthropists and nonprofit board members, have had money in Magellan, Fidelity's flagship mutual fund, since it was launched in 1963. Robin says he's known Edward C. "Ned" Johnson 3d, the company's chairman and CEO, for many years. This random selection of people is an excellent road map to the mark that Fidelity has made on Boston. Fidelity's charitable arm, the Fidelity Foundation, and the Johnson family's private foundations make multimillion-dollar donations to nearly every major cultural organization in the city – including the Boston Public Library, the Trinity Church renovation, the Museum of Fine Arts, and the Boston Symphony Orchestra – as well as to the area's hospitals, schools, and colleges.

"They're a bottom-line company, and they understand that they have to make a social commitment to the community they're in," says Mayor Thomas Menino. "Education, the Symphony, whatever it is that's good for Boston, they're involved. I've seen what Ned Johnson has done for Boston. Ned Johnsons only come along once in a century."

Fidelity is also the third largest private employer in Boston, where it currently has 8,500 of its 37,000 employees. It owns more than 3.5 million square feet of office space, including the World Trade Center and adjacent office buildings along the South Boston Waterfront, 82 and 68 Devonshire Street, 27 and 255 State Street, and 15 and 19 Congress Street. It also developed and owns the Seaport Hotel. Through its venture arm, it owns BostonCoach, the limo company, Sebastians, the catering and cafe chain, a construction supply company, an executive recruiting company, and an event planning company. It manages \$5 billion in city- and state-held cash through its money market funds, and it manages a chunk of the Massachusetts state employee pension fund.

Kris Frieswick is a freelance writer living in the South End. E-mail her at krisfrieswick@verizon.net.

MY LUNCHTIME GROUP KNOWS that Fidelity is a tremendous engine for the local economy and cultural life of our city. But these people have also heard that Fidelity is moving as many as 1,500 employees out of state, and they worry about what this portends for the company's long-term presence in Boston. Fidelity's employment levels in the city, after all, have dropped since 1990 – from 64 percent of total Fidelity employment to 23 percent. At the very least, last month's job announcement was another kick to the collective Hub sense of self, which has taken more than a few hits lately with the out-of-town acquisition of one major corporation after another.

But these Bostonians seem less worried about the state of Fidelity than about the state of the assets they have invested with Fidelity. Even Anita Lincoln, who sits on the boards of local nonprofits that have benefited from Fidelity's legendary generosity, is more concerned about the performance of her family's portfolio than about the location of some jobs. "I think that's the natural way people go," she says. "Magellan has been rather flat recently."

Such is the plight of Fidelity on its 60th birthday. Until recently, it was this country's biggest and most successful manager of other people's money, including mutual funds. With more than \$1.2 trillion in assets under its control, it is the company you and I and 21 million other people depend on to ensure our golden years have plenty of gold. It is about to announce a 2005 annual revenue that ranks among the top three in its history, and half of it came from divisions that have nothing to do with money management. But all anyone wants to talk about is its mutual funds. It shouldn't be surprised. Those funds are the legacy upon which mighty Fidelity is built. In its relentless diversification, Fidelity stands accused of taking its eye off its most important ball – managing our money. Fair or not, when its mutual funds stumble, the world thinks Fidelity has stumbled.

And its funds have stumbled. The fund that put Fidelity on the map, Magellan, had \$51 billion in assets at the end of 2005 after having soared past \$100 billion. The company's US stock funds were outperformed by half of their peer group in 2004 and 43 percent of their peer group in the three years ending in 2004, according to Fidelity's 2004 shareholder report. Over the past five years, many of the firm's largest domestic-stock offerings have posted mediocre results, according to Christopher Traulsen, a senior analyst who covers Fidelity at Morningstar Inc. And even though many of the firm's US stock funds showed strong results in 2005, it seems the damage had been done. Net flows into Fidelity funds (new customer money going into the funds, minus customer withdrawals) dropped by 69 percent in 2005 compared with 2004. Eleven other fund companies brought in more new customer money last year than Fidelity did – an unheard-of thumping for a company that until February 2004 was the largest mutual fund provider in the country. (It is now ranked third, excluding money market funds.)

UNTIL RECENTLY, FIDELITY WAS THE BIGGEST AND MOST SUCCESSFUL MANAGER I
It is the company you and I and 21 million other people depend on to ensure our
mighty Fidelity is built. Fair or not, when its mutual funds stumble, the world think



A FIDELITY TIMELINE

1946 **Edward C. Johnson 2d** founds Fidelity Management & Research Co. to act as an investment adviser to Fidelity Fund, a mutual fund started in Boston in 1930. FMR has \$13 million in assets under management.

1957 **Edward C. "Ned" Johnson 3d**, a 1954 Harvard graduate, joins his father's company as a research analyst.

1963 International Fund established; renamed the Magellan Fund in 1965.

1964 FMR establishes its Investment Management Service for pension plans.

1972 FMR Corp., a holding company, is founded. Ned Johnson is named president.

1974 Fidelity unveils Fidelity Daily Income Trust, the first money market fund with check writing.

1975 Fidelity offers Individual Retirement Accounts (IRAs).

1977 Ned Johnson becomes chairman and CEO of FMR Corp. Peter Lynch takes over the Magellan Fund.

1983 Fidelity's first investor center opens in Boston, on Congress Street.

1984 Fidelity offers computerized trading.

1984 Edward C. Johnson 2d dies. (Granddaughter Abigail Johnson, later the presumed heir, joins the company in 1988.)

1990 **Peter Lynch** retires from Magellan. After a 13-year run as portfolio manager, he grew the company's flagship mutual fund from \$22 million to \$13 billion.



2001 Abigail named president of Fidelity Management & Research Co.

2006 Magellan, after having soared past \$100 billion, is down to \$51 billion. Abigail takes a new position and leaves board of trustees, steps some see as signs her succession is in question.

2006 Fidelity, with 37,000 employees worldwide, announces it will move as many as 1,500 of its 12,800 Massachusetts jobs out of state.

THIS COUNTRY OF OTHER PEOPLE'S MONEY, INCLUDING MUTUAL FUNDS.

Golden years have plenty of gold. Those funds are the legacy upon which Fidelity has stumbled - and its funds have stumbled.

It has recently launched an aggressive plan to gain its footing, but the cost may be high. Ned Johnson is 75 – well past traditional retirement age (although most believe he will retire only through an act of God). Boston’s pundits have long assumed that the company’s succession plan, the most tightly guarded secret in Boston, would place his daughter, 44-year-old Abigail, president of Fidelity’s Employer Services Co., in the driver’s seat. But recent events have called that succession – and the closeness of that father-daughter relationship – into question.

THE JOHNSONS ARE CLASSIC BRAHMINs. They keep to themselves; they do good works with no fanfare or demand for recognition; they work hard, rarely appear at public events, and are almost never interviewed. Ned and Abigail regularly land on various lists of Planet Earth’s richest people, although no one is sure exactly what they’re worth. For most of rank-and-file Boston, the Johnson family, including Ned’s wife, Elizabeth, known as Lillie, and Ned and Lillie’s daughters Abigail and Elizabeth, known as Beth, and son Edward C. IV, is more like a myth than a flesh-and-blood family.

Fidelity is the manifestation of that quiet Brahmin probity. It has never crowed about its accomplishments. Nor does it wallow in failures, and its powerful spin machine is adept at painting smiley faces on even the most dismal mutual fund returns by encouraging investors to think long-term and by offering reporters distractions like: Look how successful our other business lines are. Needless to say, my random group of Bostonians, while pleased to hear that the Johnson family is making even more money, couldn’t care less what is happening with those other lucrative divisions. Like most investors, they care about filling their own pockets.

FIDELITY WAS BIRTHED HERE IN 1946 by Edward C. Johnson 2d, a young Milton lawyer and investment whiz, one of a number of Boston entrepreneurs with names like Cabot, Paine, and Putnam who saw the potential of “open-end” mutual funds. These funds allowed investors to move money in and out at will, unlike most of the funds of the time, which required investors to sell their shares on the open market if they wanted out. Today, says Boston University law professor Tamar Frankel, more than two-thirds of all funds are open-end.

Back in the 1940s, open-end funds and their sales organizations sprung up in Boston like daffodils in a late April snow, and Boston is still considered the home of the modern mutual fund, in which a large group of investors essentially pool their money in order that each may own a chunk, however small, of a huge, diversified portfolio of stocks, bonds, and other assets. Johnson’s new company, originally headquartered at 35 Congress Street, hired aggressive analysts who redefined the staid image of the Boston “trustee,” a conservative money manager whose goal was capital preservation for family trusts. One of them was Shanghai native Gerald Tsai Jr., who joined in 1952 and focused instead on capital appreciation – a hallmark style upon which Fidelity would build its fortune. Johnson

also abandoned the traditional concept of the investment committee, which he found cumbersome, giving responsibility for fund investment choices to single portfolio managers. It was a breakthrough that Tsai says helped gain Fidelity its eventual gorilla status.

“You have to give that credit to Mr. Johnson,” says Tsai, now a 76-year-old money management legend and head of Tsai Management Inc. in New York. “He was very open to new ideas. . . . He created the concept of the portfolio manager.” Soon, everyone was doing it.

According to Diana B. Henriques, *New York Times* business reporter and author of *Fidelity’s World: The Secret Life and Public Power of the Mutual Fund Giant*, one of the few definitive histories of Fidelity, Johnson’s vision of what the funds could be was one seed of the company’s eventual success. The second seed was the transition to power of Ned Johnson, who joined the company in 1957. He was promoted to president in 1972 and chairman and CEO in 1977 when his father’s health deteriorated. Afflicted with Alzheimer’s, the elder Johnson died in 1984.

UNENCUMBERED BY PUBLIC SHAREHOLDERS focused on quarterly earnings and fueled by a belief in his own vision, Ned Johnson invested heavily in technology, so Fidelity could administer all customer accounts in-house. He moved the company into 401(k) administration before nearly anyone had even grasped the potential of the new vehicle, which has become one of the most popular tax-sheltered investments for people saving toward retirement. He popularized the concept of allowing money market investors to write checks on their accounts. The company’s experience trading customer stock led to the creation of its retail brokerage business, now one of the largest in the country. Managing its vast properties led to a successful real estate management and development business.

“A firm like Fidelity that’s privately held can take a five- to 10-year view,” says 53-year-old Robert Reynolds, Fidelity’s chief operating officer and a member of the management committee, who joined Fidelity in 1984. “Ned probably has the longest-term time horizon of anyone I’ve ever met, which I think has been extremely important. I was initially in at the start of the 401(k) business, and there were people asking, ‘Why are you in this business? Why are you doing this?’ There was a vision that if we did things right and continued to invest over the next five to 10 years, that it would be a tremendous business for Fidelity, and that’s exactly what happened.”

Along the way, Fidelity developed a reputation as an investment company of the highest integrity, above reproach – a reputation it retained even when the occasional portfolio manager or trader got caught with his hand in the cookie jar. Its latest scandal may prove slightly more damaging. Half a dozen Fidelity traders and portfolio managers reportedly left the company last year, and 14 were fined, suspended, or reassigned after they came under investigation by the SEC and the NASD (formerly known as the National Association of Securities Dealers) for allegedly accepting excessive gifts from

“They understand that they have to make a social commitment to the community they’re in. Education, the Symphony, whatever it is that’s good for Boston, they’re involved. I’ve seen what Ned Johnson has done for Boston.

NED JOHNSONS ONLY COME ALONG ONCE IN A CENTURY.” – MAYOR THOMAS MENINO



**WHO WILL
TAKE OVER
FIDELITY
AFTER
NED JOHNSON?**



ABIGAIL JOHNSON
His daughter was the presumed heir, but now it's less certain.



ROBERT REYNOLDS
The chief operating officer has been with the company for 20 years.



ELLYN McCOLGAN
The president of Fidelity Brokerage Company is highly respected.

brokers with whom they did business.

Through the years, Johnson's relentless focus on the details helped Fidelity develop a world-class expertise in keeping track of data, records, transactions, stock certificates, anything that could be converted to bits and bytes. Today, its fastest-growing business line is selling those processing and administrative services – for retirement accounts, human resources, payroll, benefits, welfare, and health saving accounts – to other companies.

Reynolds likes to quote Ned Johnson when he says, "What mutual funds meant to the first 50 years of this company, processing will mean to the next 50."

Which, again, is great for the Johnsons and the Fidelity employees who own company stock. But where has this profound shift left me and the 21 million people who have some or all of their life savings wrapped up in Fidelity's mutual funds?

CALL IT THE PERFECT STORM on a sea of money. In June 2001, Abigail Johnson, then Fidelity's largest shareholder with about 25 percent of its stock, had just been named president of Fidelity Management & Research Co., a required stop on the march toward her destiny in Fidelity's corner office. As luck would have it, seven months earlier, a new SEC rule called Regulation Fair Disclosure had taken effect. It prohibited companies from sharing material, nonpublic information with anyone likely to trade its stocks based on that information. The rule was intended to put a stop to the sorts of back-office, wink-and-handshake conversations that CEOs tended to have with portfolio managers and analysts from big money management companies that owned lots of a company's stock. That type of information gave those big stock managers an investing edge that was denied smaller firms and individual investors, and it is generally believed that Fidelity managers relied heavily on it. Once Reg FD passed, Fidelity's portfolio managers had to rely on primary research from the company's supposedly vaunted research team, which, says Traulsen, the analyst for Morningstar, was not so much.

"I think they didn't have the research to make them stand out from their peers anymore," says Traulsen. "They used to be able to just call and get exclusive access. But when they couldn't do that anymore, they just became another fish in the sea."

The stock market collapse had begun in earnest in late spring 2001, taking down the value of large company stocks, in which Fidelity's funds, most notably the gargantuan Magellan, were heavily invested. Then came 9/11, followed by corporate scandals at Enron, WorldCom, Tyco, and others that rocked the foundation of the public's trust in the nation's corporations. Stocks continued to stagnate, and Fidelity funds' overall performance began to falter. The task of righting things fell to Abigail, whose own brief experience managing a mutual fund had not been viewed as stellar by Traulsen and others who chart Fidelity's performance.

Many of Abigail's challenges came from outside the company, but many were of the company's own making. Despite the fund perfor-

mance problems and rearranged financial landscape, the research group continued on as it always had. Many experts feel that Fidelity funds were, and still are, too big for their own good. In mutual funds this massive, size dilutes any gains or losses in the individual stocks in the portfolio. So even nimble fund managers are less able to capitalize on a soaring stock.

Others say size isn't the problem; the problem is that the company's heavy stake in the retirement market means it is restricted from moving too aggressively into risky investments that might show greater returns. Again, there were some bright spots, like Contrafund (designed to invest more aggressively), Capital Appreciation Fund, Small Cap funds, and some international funds, but they were not bright enough to fill in the black hole left by Magellan and other funds during Abigail's tenure.

The fact is that the mutual fund industry as a whole just isn't the guaranteed moneymaker it once was for Fidelity and other money management companies. Management fees are dropping, partly due to government pressure, partly due to Fidelity's own efforts to cut fees. The growth of the mutual fund market as a whole has slowed due to the rise of hedge funds and other, more sophisticated investment options.

Maybe this is why Reynolds is so excited about Fidelity's non-mutual-fund opportunities, which include a massive move into individually managed portfolios for institutions and pension funds. "Mutual funds will play a huge role [in the future], because it's still the best way for people to invest on a cost basis, for diversification and professional money management," says Reynolds. "That being said, we've made a major investment in building a separate organization focused on the institutional business. We think there's going to be a huge opportunity going forward to manage more workplace savings, defined benefit, and other types of accounts like that," whether those accounts are invested in Fidelity-branded mutual funds or not, he adds.

As part of this new initiative, Fidelity announced last July that it was rolling up its institutional asset management division, renaming it Pyramis Global Advisors, and moving it to Rhode Island, for a loss of an unspecified number of Boston jobs by 2008. It's all part of Ned Johnson's long-term plan to double assets under management – a goal it's unlikely the company will hit through mutual fund asset growth alone.

EXPERTS WHO WATCH FIDELITY say that sometime in early 2005, it became apparent that if mutual fund performance continued to suck wind, it would be very difficult for Fidelity to achieve its goal of persuading all those big institutions and pension funds – expected to play a substantial role in Fidelity's future – to entrust their billions with the company.

"Regardless of how diversified they become," says Traulsen, "or how great these other revenue streams are, the mutual fund business is what's going to carry the Fidelity flag in the public eye."

And the institutional customer's eye as well. Last week, the pension board that oversees the Massachusetts employee pension fund approved a recommendation that it pull \$370 /// CONTINUED ON PAGE 30

Fidelity officials won't comment on the company's top-secret succession plan, and Robert Reynolds, Fidelity's chief operating officer, won't absolutely rule out a potential future sale of parts of the company. **"TO SAY NEVER WOULD BE STUPID,"** he says, but he adds that a sale "is not in our DNA."

million of the pension fund's large cap equity allocation away from its Fidelity portfolio manager and give it to another company. Massachusetts Treasurer Tim Cahill, the pension board's chairman, blames long-term performance issues and the departure of portfolio manager Steven Kaye. Two other pension funds, the Public School Teacher's Pension and Retirement Fund of Chicago and the San Diego City Employees Retirement Systems, have put a total of about \$450 million in Fidelity-controlled assets up for review, citing performance issues and concerns over the gift-giving probe. (Fidelity continues to manage high-yield bond assets for the Massachusetts pension fund and a money market account for cities' and counties' cash reserves, both of which have performed well, says Cahill.)

Fidelity management, concerned about just these sorts of defections, realized that profound changes were necessary in the money management division. And Abigail wasn't making them. In May 2005, after a four-year struggle to right a badly listing ship, she was replaced by Stephen Jonas as head of Fidelity Management & Research Co. Abigail was made president of Fidelity Employer Services Co., a shift billed by company executives as a promotion to a hot growth division. Observers question that characterization.

"I don't pretend for a minute that she took the other job without some sense of 'We need to make changes, and I'm not the person to do it,'" says Eric Kobren, founder of "Fidelity Insight," a Fidelity fund tracking newsletter, creator of the Kobren Growth Fund mutual fund, and a former Fidelity group marketing director. "I don't think her personality was as forceful to embrace change and to whack people if she had to. That's one thing her father does. He pays people well, but they're employees, and he'll use them while they suit the company's purpose, and when it's time to move on, it's time to move on."

It is a policy from which even his own daughter may not be exempt. "Frankly, I think it was a demotion for Abby," says Traulsen. "They billed it as a voluntary planned transition, but I think it's clear that the mutual fund division had not excelled under her."

In addition to the management change, the company has plans to double the size of its research staff. It will make research a lucrative career track unto itself, allowing analysts to specialize in sectors they like and spend years learning its intricacies. Previously, research was a training ground for portfolio managers. In a strange echo from the investment committees of long ago, Fidelity has also begun assigning several portfolio managers to manage larger funds together, an arrangement used very successfully at other big mutual fund competitors like American Funds. It has moved more aggressively into index funds that mimic the look and feel of benchmarks like the S&P 500. A new manager was assigned to Magellan in November, and early signs seem positive that a turnaround may be afoot.

THE CHANGES AT FIDELITY have raised new questions about the future leadership of the firm. In October, Abigail reduced her personal ownership stake in Fidelity by selling a percentage of it to family trusts, the shares of which are voted by her father. The company attributed the shift to estate planning. In December, Abigail stepped down from her role as a member of the Fidelity mutual fund board of trustees. Fidelity spokeswoman Anne Crowley says that due to Abigail's new role with Employer Services, she's not involved with mutual funds anymore, and her departure from the board was a natural step.

Several Fidelity watchers, as well as an acquaintance of the John-

sons, believe she was pushed and that there is animosity between father and daughter as a result of the recent changes. But Crowley says that "they haven't confirmed anything like that to anyone." Many question whether these changes signal a shift in the long-assumed succession of Abigail to her father's throne. Even if someone else ascends to chairman and CEO, the Johnson family will still remain the company's owners, and there are plenty of highly capable executives, including Reynolds and Elyn McColgan, president of Fidelity Brokerage Company, whom observers point to as possible successors. Other Fidelity observers are talking about potential suitors if the Johnsons do the unthinkable and liquidate their stake. (Financial industry trackers have tossed around names like Bank of America as a potential acquirer, should it come to that.) Fidelity officials won't comment on the company's top-secret succession plan, and Reynolds won't absolutely rule out a potential future sale of parts of the company.

"To say never would be stupid," says Reynolds, but he adds that a sale "is not in our DNA." If anything, he adds, Fidelity may be looking to acquire other companies in the right areas.

Still, trying to catch a glimpse of Fidelity's succession soap opera playing out behind those big locked mahogany doors has everyone asking crazy questions. What if Ned Johnson does do the unthinkable and sells to an outside bidder, perhaps a financial conglomerate? Investors would lose a champion who, despite criticism of some of his methods and motives, has consistently placed the interests of mutual fund investors next to his own.

The new owners would undoubtedly keep a presence in Boston but eliminate "redundancies" locally, much as Bank of America did when it bought Fleet, and as P&G is expected to do with Gillette. It would likely reduce Fidelity's legendary levels of philanthropic donations and unload its valuable local real estate. The trickle-down effect would be profound for businesses that transact with Fidelity and its employees.

This, of course, is all wild speculation – a thing that tends to flourish amid uncertainty.

In the final analysis, this is what Fidelity means to Boston on its 60th birthday. It is a 780-pound gorilla, our hometown international financial powerhouse that has left its fingerprints on nearly everything we see, no matter what street we walk down. At its center dwells a family that has the power to alter the lives and livelihoods of nearly everyone in this town – ordinary investors, politicians, nonprofit doyennes, rich, poor, old, and young. Only a handful of people in Boston are privy to this great ruling clan's next move, and they're not telling. Fidelity's Crowley offers these words: "We expect Massachusetts to continue as our headquarters, and we expect to continue to have a significant workforce here." With Boston seeing so many giants flee, the word "expect" from the mouth of Fidelity is not exactly the most reassuring.

As for a money management turnaround, we'll take our cue from the Fidelity faithful, like Malcolm McDonald, on his way to a meeting on a cold Wednesday in Copley Square. "I've been fortunate," he says. "My [Fidelity] investments have done well. I'm sure other people haven't been as fortunate." The truth is that in its 60 years, Fidelity has created far more wealth, for investors and the city, than it has lost – and that buys a lot of faith and patience. So we're content to sit back with McDonald and the rest of the lunchtime crowd and see if the company that made today's generations of retiring folk very comfortable will succeed in finding a way to do the same for their children and grandchildren. **BG**