
News Release

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National Survey: Large Capital Gains Distributions in a Year of Negative Returns Has Mutual Fund Investors More Concerned About Investment Taxes

Shareholders Remain Bullish in Their Investment Outlook

Popularity of Index Funds Drops Significantly

(February 13, 2001) BOSTON- - Stung by large capital gains distributions in a year of negative investment returns, mutual fund shareholders increasingly consider taxes to be an important investment consideration, according to the results of an annual survey of investors released today by Eaton Vance Corp.

The nation-wide survey of investors, conducted by Penn, Schoen and Berland Associates, indicates that an overwhelming majority of investors (84%) considers the impact of taxes on their stock mutual funds to be an important consideration when making investment decisions. Nearly 60% (58%) of investors say that the impact of taxes on their investment returns has *increased in importance* over the past year.

“Investors who had been less aware of mutual fund taxes had a rude awakening in 2000, when many funds had low or negative returns but still paid out large taxable distributions,” observed Duncan W. Richardson, senior vice president of Eaton Vance and portfolio manager of The Eaton Vance Tax-Managed Growth Fund. “The combination of strong built-up gains carried over from prior years, high portfolio turnover in a volatile market and an insensitivity to tax considerations on the part of most fund managers created a “Perfect Storm” that dumped large capital gains distributions on many unsuspecting shareholders. Many shareholders who in the past might have been dismissive about fund taxes were horrified to learn they will be paying taxes on fund investments on which they lost money last year.”

Consistent with the growing concern regarding fund taxes, 82% of investors consider disclosure by mutual fund organizations of the tax implications of fund investing to be important. Nearly nine in ten (85%) investors say they carefully examine their investment statements to determine the degree to which taxes affect their returns and three out of five investors (60%) believe the U.S. government should require mutual fund providers to state after-tax returns for stock mutual funds, supporting the objective of the Securities and Exchange Commission’s new after-tax return disclosure requirement. Although the new SEC rule requiring disclosure of after-tax returns was finalized only last month and does not fully go into effect until the first quarter of 2002, 30% of investors are already aware of this coming requirement for all long-term mutual funds.

While Investment Taxes May Be Considered Important, Understanding of the Subject is Still Low

Although most investors recognize the importance of tax considerations, they have only a limited understanding of investment-related tax issues. One in four investors (25%) do not know their current federal income tax bracket. One in four investors (26%) are unfamiliar with the concept of “tax-efficient” investing, and one in three investors (33%) are unable to cite any investments that offer high tax efficiency.

When asked whether they would be more inclined to hold municipal bonds and municipal bond funds in a qualified retirement plan such as an IRA or 401(K) plan or outside such a plan, survey respondents were equally likely to say they would hold such investments within a qualified plan (39%) as outside a qualified plan (40%.) Similar questions addressing investments in variable annuities and tax-managed stock funds received similar responses. Survey respondents were equally likely to favor use of variable annuities within a qualified plan (39%) versus outside a qualified plan (40%), and only somewhat more in favor of using tax-managed stock funds outside of a qualified plan (49%) versus inside a qualified plan (38%).

“In reality, each of these tax-free or tax-deferred investments is particularly well suited to being held *outside* of a qualified retirement plan,” commented Thomas E. Faust Jr., executive vice president and chief equity investment officer at Eaton Vance. “Investors should utilize within their qualified retirement plans investments that would otherwise be subject to current tax on income and realized gains. It is clear from the survey results that only a minority of American investors are sophisticated enough in their understanding of investment taxes to make intelligent choices about how best to hold assets of different character.”

Although the state of investors’ understanding of tax issues remains discouraging, the situation has improved in the past year. Compared to last year’s survey, nearly twice as many respondents (23% vs. 12%) correctly associated tax efficiency with minimizing the difference between returns before and after taxes. Also in the past year, investors’ familiarity with tax-managed mutual funds that have an objective of after-tax returns increased substantially. In this year’s survey, 35% of respondents said they were familiar with tax-managed funds, versus only 20% who were familiar with this investment product a year ago. Also nearly double last year’s results, 27% said they understand the difference between tax-efficient funds that are managed passively versus actively, up from 15% last year.

“Former SEC Chairman Arthur Levitt has identified taxes as the single largest expense associated with mutual fund investing, reducing the average stock fund’s returns by more than 2.5% per year,” commented Mr. Faust. “We are encouraged that investors are taking increased notice of tax-managed funds that are designed to minimize the tax bite and managed toward a goal of after-tax returns.”

Recognizing the importance of tax considerations and their lack of understanding in this area, many investors turn to professional advisors or financial consultants for assistance. In this year’s

survey, fully 70% of respondents said they use a broker or financial advisor for help with investing, and 22% of those who have previously invested strictly on their own indicate that they are very likely (10%) or somewhat likely (12%) to use a financial professional in the next year. Of investors who use a broker or financial advisor, 72% say they discuss the tax implications of their investments to at least a limited extent. Financial advisors have a key role to play in educating investors about tax considerations and ensuring that they hold appropriate investments in their taxable and non-taxable investment accounts.

Investors are Long-Term Focused, Mostly Bullish About the Stock Market for 2001

Nine in 10 investors (90%) say they have solely a long-term investment focus (55%) or an investment focus that is more long-term than short-term (35%). “We are encouraged again by the stated long-term horizon expressed by investors in this year’s survey. We feel a long-term perspective is necessary to maximize the potential for equity investors to accumulate wealth,” said Mr. Faust. “Too often people who should be investors act like traders, exposing themselves unnecessarily to the dual drags on performance from trading costs and capital gains taxes.”

Recent volatility in equity markets prompted only 15% of surveyed investors to change the amount they have invested in mutual funds, with 36% of those making changes increasing their investments and 59% decreasing their investments. Only 11% of investors reallocated their investments in bonds for this reason. While more than half (54%) of surveyed investors said they have less appetite for risk going forward given recent stock market developments, 22% of those surveyed now have a greater appetite for risk and 18% the same amount of appetite for risk (6% are unsure).

When asked how they deal with a loss in a stock or mutual fund, 43% of survey respondents said they typically do nothing; 18% said they tend to buy more since the investment is cheaper; and 17% indicated they tend to do nothing immediately but typically would sell the investment when it gets back to the break-even point. Only 16% of survey respondents said they would tend to sell the investment right away to capture the tax value of the loss.

“The loss aversion seen in the study is consistent with the behavioral finance analysis done by Professors Terrance Odean of the Graduate School of Management at the University of California, Davis and Richard Thaler at the University of Chicago Graduate School of Business,” said Mr. Richardson. “Their work suggests that investment behavior is influenced by natural human tendencies which cause investors to overtrade and to not admit mistakes. Unfortunately these traits often frustrate achieving higher after-tax returns.”

In their outlook for the market over the next year, investors are more bullish (57%) than bearish (30%). Nearly two-thirds of surveyed investors (62%) think the return of the S&P 500 index will be positive in 2001. Among these investors, more than half (61%) think the return will exceed 6% in 2001, and 22% think the return will exceed 10%. More than half of surveyed investors (52%) think the return of the NASDAQ Composite Index will be positive in 2001. Among these investors, nearly half (46%) think the return will exceed 10%. Nearly 60% of investors do not think the U.S. will experience a recession in 2001; 34% think there will be a recession and 7% are uncertain.

When asked what they think might be the biggest surprise for investors in 2001, a strong market rebound was mentioned by the highest number of those surveyed (17%). Tying for second at 4%

each were: a good economy without recession; rebounding of technology stocks; further downturn in the market; and President Bush's tax plan being passed.

41% of surveyed investors identify themselves as "momentum" investors and 28% consider themselves "contrarian" investors, with the remainder not having a specific style or not knowing how to identify their style.

Investors are Split Over Technology Stocks for the Coming Year but Most Feel They are a Good Longer-Term Investment / Most Investors Have Not Reduced Their Exposure to Technology Stocks

Investors are of two minds when it comes to the expected performance of technology stocks for the current year, but most believe they will rebound within the next three years and represent a good longer-term investment.

One in five surveyed investors (21%) predicts technology will be the *best performing* investment area or industry sector in 2001, but nearly twice as many (38%) think technology will be the *worst performing* sector for the year. Energy (8%) and pharmaceuticals (8%) were tied for second best bets. Automotive (5%) and utilities (5%) were tied for second worst groups to invest in.

"When asked about different market sectors, the investment area that elicited by far the strongest sentiment – for better or worse – was technology," observed Mr. Richardson. "Love or hate the sector in the short-term, it is clearly one that the public feels will continue to be a major market force to be reckoned with."

One in three surveyed investors (33%) said that technology stocks will be a good investment and 43% said they will be a fair investment in 2001. One in five investors (20%) said technology stocks will be a poor investment this year. More than six in 10 investors (61%) said that technology stocks will be a good investment over the next three years and 30% said they will be a fair investment over this time period. Only 6% of investors said technology stocks will be a poor investment over the next three years.

Investors' attitudes toward technology stocks reflect their long-term optimism about investing and the stock market. Many investors who have expressed concerns about the outlook for technology stocks have not taken action to reduce their exposure to the sector. More investors (31%) have increased their exposure to technology stocks over the past 12 months than have decreased their exposure (24%). The largest group—38% of investors—made no change.

Popularity of Index Fund Investing May Be Peaking

One of the most popular investment products of the 1990s—passively managed index funds that mimic the movements of major market indices—may have reached a peak in their popularity. When asked whether they will be more likely or less likely to invest in index funds in the next couple of years, a majority of survey respondents (51%) said they are *less likely* to do so (29% more likely; 20% the same or no response). Among investors who said they were less likely to purchase index funds, the most commonly cited reason (31%) was higher market volatility.

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“Data from the survey supports Eaton Vance’s view that we are past the peak of popularity for passive investing,” commented Mr. Richardson. “The year 2000 partially exposed the fatal flaw of indexing—the fact that indices are constructed without applying any valuation discipline or investment judgment. In the results of 2000, investors experienced the risks of this approach and are now beginning to vote with their feet.”

The survey revealed that investors have a poor understanding of how major stock market indices are constructed. When asked what criteria are most important to Standard & Poor’s in selecting stocks for its indices, nearly half of all surveyed investors (44%) said, incorrectly, that stocks are selected on the basis of their investment merits or the attractiveness of their valuations. Only 24% of surveyed investors correctly identified the primary basis for inclusion in an S&P index, which is that adding the company to the index would make the index more representative of the U.S. economy.

This study represents a detailed portrait of American investors’ attitudes and practices, specifically with reference to the tax implications of investing. The study was conducted by Penn, Schoen & Berland Associates, Inc. for Eaton Vance Corp. in February 2001. The study was based on a comprehensive, nationally representative telephone survey of 500 U.S. residents who have invested in both qualified retirement plans *and* investments outside of qualified retirement plans (stock mutual funds, bond mutual funds, individual stocks, individual bonds, variable annuities or money market funds). The median annual income of survey respondents was \$100,000. The margin of error for the study was +/- 4.4% at the 95% confidence level.

Penn, Schoen & Berland Associates, Inc. (PSB) is a Washington DC-based full-service strategic polling and market research firm whose clients have included numerous senators, congressmen, other national and international political leaders, over 20 Fortune 100 companies and numerous trade associations.

Eaton Vance Corp., a Boston-based investment management firm, is traded on the New York Stock Exchange under the symbol EV.

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