How To Avoid the Worst Style Mutual Funds

Question: Why are there so many mutual funds?

Answer: Mutual fund providers tend to make lots of money on each fund so they create more products to sell.

The large number of mutual funds has little to do with serving investors' best interests. Below are three red flags investors can use to avoid the worst mutual funds:

1. Inadequate Liquidity

This issue is the easiest issue to avoid, and our advice is simple. Avoid all mutual funds with less than $100 million in assets. Low levels of liquidity can lead to a discrepancy between the price of the mutual fund and the underlying value of the securities it holds. Plus, low asset levels tend to mean lower volume in the mutual fund and larger bid-ask spreads.

2. High Fees

Mutual funds should be cheap, but not all of them are. The first step here is to know what is cheap and expensive.

To ensure you are paying at or below average fees, invest only in mutual funds with total annual costs below 1.95%, which is the average total annual cost of the 6391 U.S. equity Style mutual funds we cover.

Figure 1 shows the most and least expensive style mutual funds. Empiric provides one of the most expensive mutual funds while Vanguard mutual funds are among the cheapest.

Figure 1: 5 Least and Most Expensive Style Mutual Funds

Ticker	Name	Style	Total Annual Cost
	Most Expensive		
EMCAX	Mutual Fund Series Trust: Empiric 2500 Fund	Small Cap Blend	7.52%
COPLX	Copley Fund, Inc	All Cap Value	7.13%
MOFQX	Marketocracy Funds: Masters 100 Fund	Small Cap Blend	6.97%
PAGTX	Pacific Advisors Fund Inc: Large Cap Value Fund	Large Cap Blend	6.90%
MLPSX	ProFunds: Mid-Cap Value ProFund	Mid Cap Value	6.76%
	Least Expensive		
VSMPX	Vanguard Total Stock Market Index Fund	All Cap Blend	0.02%
FXAIX	Fidelity Concord Street Trust: Spartan 500 Index Fund	Large Cap Blend	0.03%
VIIIX	Vanguard Institutional Index Fund	Large Cap Blend	0.03%
VITPX	Vanguard Institutional Total Stock Market Index Fund	All Cap Blend	0.03%
FFSMX	Fidelity Concord Spartan Total Market Index Fund	All Cap Blend	0.04%

Sources: New Constructs, LLC and company filings

Investors need not pay high fees for quality holdings. Eaton Vance Hexavest US Equity Fund (EHUIX) earns our Very Attractive rating and has low total annual costs of only 1.22%.

On the other hand, no matter how cheap a mutual fund, if it holds bad stocks, its performance will be bad. The quality of a mutual fund's holdings matters more than its price.

3. Poor Holdings

Avoiding poor holdings is by far the hardest part of avoiding bad mutual funds, but it is also the most important because a mutual fund's performance is determined more by its holdings than its costs. Figure 2 shows the mutual funds within each style with the worst holdings or portfolio management ratings.

Figure 2: Style Mutual Funds with the Worst Holdings

Ticker	Name	Style	Portfolio Management Rating
DAVAX	Northern Lights: Footprints Discover Value	All Cap Blend	Very Dangerous
SGFFX	Sparrow Funds: Sparrow Growth Fund	All Cap Growth	Dangerous
COPLX	Copley Fund, Inc	All Cap Value	Dangerous
GARTX	Goldman Sachs Absolute Return Tracker Fund	Large Cap Blend	Very Dangerous
AIXAX	Mutual Fund Series Trust: Catalyst Activist Investor Fund	Large Cap Growth	Dangerous
GHTAX	Northern Lights: Good Harbor Tactical Equity Income	Large Cap Value	Dangerous
GWSAX	Gabelli Focus Five Fund	Mid Cap Blend	Dangerous
GAMAX	Starboard Goodwood SMID Cap Discovery	Mid Cap Growth	Dangerous
MLPSX	ProFunds: Mid-Cap Value ProFund	Mid Cap Value	Dangerous
SSSDX	SSgA Dynamic Small Cap Fund	Small Cap Blend	Dangerous
GUCAX	AllianzGI Ultra Micro Cap	Small Cap Growth	Dangerous
DASVX	Dunham Small Cap Value Fund	Small Cap Value	Dangerous

Sources: New Constructs, LLC and company filings

Northern Lights appears more often than any other providers in Figure 2, which means that they offer the most mutual funds with the worst holdings.

Our overall ratings on mutual funds are based primarily on our stock ratings of their holdings.

The Danger Within

Buying a mutual fund without analyzing its holdings is like buying a stock without analyzing its business and finances. Put another way, research on mutual fund holdings is necessary due diligence because a mutual fund's performance is only as good as its holdings' performance.

PERFORMANCE OF MUTUAL FUND's HOLDINGs = PERFORMANCE OF MUTUAL FUND

Disclosure: David Trainer and Max Lee receive no compensation to write about any specific stock, style, or theme.

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2. Standard for all companies.
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