



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 1.87%, which is the average total annual cost of the 6,091 U.S. equity Style mutual funds we cover. The weighted average is lower at 1.19%, which highlights how investors tend to put their [money in ETFs with low fees](#).

Figure 1 shows Aberdeen US Mid Cap Equity Fund (GUEAX) is the most expensive style mutual fund and Fidelity SAI US Large Cap Index Fund (FLCPX) is the least expensive. American Growth (AMRAX, AMRBX, AMRGX) provides 3 of the most expensive mutual funds while Fidelity (FLCPX, FFSMX, FSKAX) mutual funds are among the cheapest.

Figure 1: 5 Least and Most Expensive Style Mutual Funds

Ticker	Name	Style	Total Annual Cost
Most Expensive			
GUEAX	Aberdeen US Mid Cap Equity Fund	Mid Cap Blend	16.63%
CGJYX	Calvert US Large Cap Growth Responsible	All Cap Growth	11.78%
AMRAX	American Growth Fund Series One	All Cap Blend	8.48%
AMRBX	American Growth Fund Series One	All Cap Blend	8.20%
AMRGX	American Growth Fund Series One	All Cap Blend	8.10%
Least Expensive			
FLCPX	Fidelity SAI US Large Cap Index Fund	Large Cap Blend	0.01%
VFFSX	Vanguard 500 Index Fund	Large Cap Blend	0.01%
VSTSX	Vanguard Total Stock Market Index Fund	All Cap Blend	0.01%
FFSMX	Fidelity Total Market Index Fund	All Cap Blend	0.02%
FSKAX	Fidelity Total Market Index Fund	All Cap Blend	0.02%

Sources: New Constructs, LLC and company filings

Investors need not pay high fees for quality holdings. Nuveen Concentrated Core Fund (NCARX) earns our Very Attractive rating and has low total annual costs of only 1%.



On the other hand, Nationwide Portfolio Completion Fund (NAAIX) holds poor stocks and receives our Very Dangerous rating, yet has low total annual costs of 0.82%. 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
COREX	Avondale Core Investment Fund	All Cap Blend	Very Dangerous
ZVGIX	Zevenbergen Genea Fund	All Cap Growth	Dangerous
RFVIX	RiverPark Focused Value Fund	All Cap Value	Dangerous
ICEQX	Ivy Core Equity Fund	Large Cap Blend	Dangerous
PCLCX	PACE Large Growth Equity Investments	Large Cap Growth	Dangerous
MSYSX	AMG Systematic Large Cap Value Fund	Large Cap Value	Dangerous
RSVYX	Victory RS Value Fund	Mid Cap Blend	Dangerous
PYSYX	Putnam Equity Spectrum Fund	Mid Cap Growth	Very Dangerous
GOODX	GoodHaven Fund	Mid Cap Value	Dangerous
UISCX	USAA Small Cap Stock Fund	Small Cap Blend	Very Dangerous
PCSGX	PACE Small/Medium Growth Equity Investments	Small Cap Growth	Very Dangerous
HWSIX	Hotchkis & Wiley Small Cap Value Fund	Small Cap Value	Dangerous

Sources: New Constructs, LLC and company filings

PACE (PCLCX and PCSGX) appears more often than any other providers in Figure 2, which means that they offer the most mutual funds with the worst holdings.

RiverPark Focused Value Fund (RFVIX) is the worst rated mutual fund in Figure 2. Zevenbergen Genea Fund (ZVGIX), Hotchkis & Wiley Small Cap Value (HWSIX), PACE Large Growth Equity Investments (PCLCX), PACE Small/Medium Growth Equity Investments (PCSGX), Putnam Equity Spectrum Fund (PYSYX), GoodHaven Funds Trust (GOODX), Avondale Core Investment Fund (COREX), (Victory RS Value Fund (RSVYX), and USAA Small Cap Stock Fund (UISCX) also earn a Very Dangerous [predictive overall rating](#), which means not only do they hold poor stocks, they charge high total annual costs.

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. Don't just take our word for it, [see what Barron's says](#) on this matter.

PERFORMANCE OF MUTUAL FUND'S HOLDINGS = PERFORMANCE OF MUTUAL FUND

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How New Constructs Creates Value for Clients

We find it. You benefit. Cutting-edge technology enables us to scale our [forensic accounting expertise](#) across 3000+ stocks. We shine a light in the dark corners of SEC filings so our clients can make safer, more informed decisions.

Our [stock rating methodology](#) instantly informs you of the quality of the business and the fairness of the stock's valuation. We do the diligence on earnings quality and valuation so you don't have to.

In-depth risk/reward analysis underpins our ratings. Our rating methodology grades every stock, ETF, and mutual fund according to what we believe are the 5 most important criteria for assessing the quality of an equity. Each grade reflects the balance of potential risk and reward of buying that equity. Our analysis results in the 5 ratings described below. Very Attractive and Attractive correspond to a "Buy" rating, Very Dangerous and Dangerous correspond to a "Sell" rating, while Neutral corresponds to a "Hold" rating.

QUESTION: Why shouldn't fund research be as good as stock research? Why should fund investors rely on backward-looking price trends?

ANSWER: They should not.

Don't judge a fund by its cover. Take a look inside at its holdings and understand the quality of earnings and valuation of the stocks it holds. We enable you to choose the best fund based on its stock-picking merits so you do not have to rely solely on backward-looking technical metrics.

The drivers of our [forward-looking fund ratings](#) are Portfolio Management (i.e. the aggregated ratings of its holdings) and Total Annual Costs. The Total Annual Costs Rating ([details here](#)) captures the all-in cost of being in a fund over a 3-year holding period, the average period for all fund investors.

Our Philosophy About Research

Accounting data is not designed for equity investors, but for debt investors. [Accounting data must be translated into economic earnings](#) to understand the profitability and valuation relevant to equity investors. Respected investors (e.g. Adam Smith, Warren Buffett and Ben Graham) have repeatedly emphasized that accounting results should not be used to value stocks. [Economic earnings](#) are what matter because they are:

1. Based on the complete set of financial information available.
2. Standard for all companies.
3. A more accurate representation of the true underlying cash flows of the business.

Additional Information

Incorporated in July 2002, [New Constructs](#) is an independent publisher of investment research that provides clients with consulting and research services. We specialize in quality-of-earnings, forensic accounting and discounted cash flow valuation analyses for all U.S. public companies. We translate accounting data from 10Ks into economic financial statements, i.e. [NOPAT](#), [Invested Capital](#), and [WACC](#), to create [economic earnings models](#), which are necessary to understand the true profitability and valuation of companies. Visit the [Free Archive](#) to download samples of our research. New Constructs is a [BBB accredited](#) business and a member of the [Investorside Research Association](#).



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