



How to Avoid the Worst Sector 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 your best interests. Below are three red flags you can use to avoid the worst mutual funds:

1. Inadequate Liquidity

This issue is the easiest 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 2.22%, which is the average total annual costs of the 692 U.S. equity sector mutual funds we cover. The weighted average is lower at 1.29%, which highlights how investors tend to put their [money in mutual funds with low fees](#).

Figure 1 shows Rydex Real Estate Fund (RYREX) is the most expensive sector mutual fund and Vanguard Real Estate II Index Fund (VRTPX) is the least expensive. Rydex (RYREX, RYESX, RYCRX) provides three of the most expensive mutual funds while Fidelity (FESIX, FSRNX, FSRVX) ETFs are among the cheapest.

Figure 1: 5 Most and Least Expensive Sector Mutual Funds

Ticker	Name	Sector	Total Annual Cost
Most Expensive			
RYREX	Rydex Real Estate Fund	Real Estate	8.39%
RYESX	Rydex Energy Services Fund	Energy	7.73%
RYCRX	Rydex Real Estate Fund	Real Estate	7.38%
SFPAX	Saratoga Financial Services Portfolio	Financials	6.84%
SBMBX	Saratoga Energy and Basic Materials Portfolio	Energy	6.81%
Least Expensive			
VRTPX	Vanguard Real Estate II Index Fund	Real Estate	0.09%
FESIX	Fidelity SAI Real Estate Index Fund	Real Estate	0.09%
FSRNX	Fidelity Salem Real Estate Index Fund	Real Estate	0.09%
FSRVX	Fidelity Sale Real Estate Index Fund	Real Estate	0.12%
VHCIX	Vanguard Health Care Index	Healthcare	0.12%

Sources: New Constructs, LLC and company filings

Investors need not pay high fees for quality holdings¹. Vanguard Health Care Index (VHCIX) is the best ranked sector mutual fund in Figure 1. VHCIX's Neutral [Portfolio Management rating](#) and 0.12% total annual cost earns it an Attractive rating². Vanguard Consumer Staples Index Fund (VCSAX) is the best ranked sector mutual fund

¹ Ernst & Young's recent white paper "[Getting ROIC Right](#)" proves the superiority of our holdings research and analytics.

² Harvard Business School features the powerful impact of our research automation technology in the case [New Constructs: Disrupting Fundamental Analysis with Robo-Analysts](#).



overall. VCSAX's Attractive Portfolio Management rating and 0.12% total annual cost earns it a Very Attractive rating.

On the other hand, Vanguard Real Estate II Index Fund (VRTPX) holds poor stocks and receives our Unattractive rating, yet has low total annual costs of 0.09%. 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 sector with the worst holdings or [portfolio management ratings](#).

Figure 2: Sector Mutual Funds with the Worst Holdings

Ticker	Name	Sector	Portfolio Management Rating
FMFEX	Fidelity Advisor Materials Fund	Basic Materials	Unattractive
VCDAX	Vanguard Consumer Discretionary Index Fund	Consumer Cyclical	Unattractive
PGCYX	Putnam Global Consumer Fund	Consumer Non-cyclical	Unattractive
VGELX	Vanguard Energy Fund	Energy	Unattractive
DVIFYX	Davis Financial Fund	Financials	Unattractive
HGHFX	Hartford Healthcare Fund	Healthcare	Unattractive
RYPIX	Rydex Transportation Fund	Industrials	Unattractive
VRREX	Virtus Duff & Phelps Real Estate Securities Fund	Real Estate	Unattractive
PGTIX	T Rowe Price Global Technology Fund	Technology	Unattractive
VTCA	Vanguard Telecommunication Services Index	Telecom Services	Unattractive
FUGIX	Fidelity Advisor Utilities Fund	Utilities	Unattractive

Sources: New Constructs, LLC and company filings

Vanguard (VGELX, VCDAX, VTCA) appears more often than any other providers in Figure 2, which means that they offer the most mutual funds with the worst holdings.

Virtus Duff & Phelps Real Estate Securities Fund (VRREX) is the worst rated mutual fund in Figure 2 and also earns a Very Unattractive [predictive overall rating](#), which means not only does it hold poor stocks, it charges high total annual costs.

Our [overall ratings on mutual funds](#) are on our [stock ratings](#) of their holdings and the total annual costs of investing in the fund.

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

Analyzing each holding within funds is no small task. Our [Robo-Analyst technology](#) enables us to perform this diligence with scale and provide the [research needed](#) to [fulfill the fiduciary duty of care](#). More of the biggest names in the financial industry (see [At BlackRock, Machines Are Rising Over Managers to Pick Stocks](#)) are now embracing technology to leverage machines in the investment research process. Technology may be the only solution to the dual mandate for research: cut costs and fulfill the fiduciary duty of care. Investors, clients, advisors and analysts deserve the latest in technology to get the diligence required to make prudent investment decisions.

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Disclosure: David Trainer and Kyle Guske II receive no compensation to write about any specific stock, sector, or theme.

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2. **Un-conflicted** - Clients deserve unbiased research.
3. **Transparent** - Advisors should be able to show how the analysis was performed and the data behind it.
4. **Relevant** - Empirical evidence must provide [tangible, quantifiable correlation](#) to stock, ETF or mutual fund performance.

Value Investing 2.0: Diligence Matters: Technology is Key to Value Investing With Scale

Accounting data is only the beginning of fundamental research. It must be translated into economic earnings to truly understand profitability and valuation. This translation requires deep analysis of footnotes and the MD&A, a process that our [robo-analyst technology](#) empowers us to perform for thousands of stocks, ETFs and mutual funds.



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