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 1.76%, which is the average total annual cost of the 6137 U.S. equity Style mutual funds we cover. The weighted average is lower at 1.32%, which highlights how investors tend to put their money in mutual funds with low fees.

Figure 1 shows American Growth Fund Series One (AMRBX) is the most expensive style mutual fund and Fidelity Series Large Cap Growth Index (FHOFX) is the least expensive. American Growth Fund (AMRBX, AMRAX) provides two of the most expensive mutual funds while Fidelity (FHOFX, FFSMX, FSKAX) mutual funds are among the cheapest.

Figure 1: 5 Most and Least Expensive Style Mutual Funds

Ticker	Name	Style	Total Annual Cost
Most Expensive			
AMRBX	American Growth Fund Series One	All Cap Blend	12.04%
AMRAX	American Growth Fund Series One	All Cap Blend	8.76%
BUYAX	Catalyst Buyback Strategy Fund	All Cap Blend	8.39%
PSLAX	Putnam Small Cap Value Fund	Small Cap Value	8.32%
RYANX	Rydex Series Nova Fund	All Cap Blend	8.17%
Least Expensive			
FHOFX	Fidelity Series Large Cap Growth Index	Large Cap Growth	0.01%
VFFSX	Vanguard 500 Index Fund	Large Cap Blend	0.02%
VSTSX	Vanguard Total Stock Market Index	All Cap Blend	0.02%
FFSMX	Fidelity Total Market Index	All Cap Blend	0.02%
FSKAX	Fidelity Total Market Index	All Cap Blend	0.02%

Sources: New Constructs, LLC and company filings

Investors need not pay high fees for quality holdings.[1] Fidelity Series Large Cap Growth Index (FHOFX) is the best ranked style mutual fund in Figure 1. FHOFX's Neutral Portfolio Management rating and 0.01% total annual cost earns it an Attractive rating.[2] Deutsche DWS CROCI U.S. Fund (DCURX) is the best ranked style mutual fund overall. DCURX's Attractive Portfolio Management rating and 0.88% total annual cost earns it a Very Attractive rating.

On the other hand, Fidelity Small Cap Index (FSSNX) holds poor stocks and earns our Unattractive rating, yet has low total annual costs of 0.10%. 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
ADLVX	Ultimus Managers Adler Value Fund	All Cap Blend	Very Unattractive
ZVNIX	Zevenbergen Growth Fund	All Cap Growth	Unattractive
COPLX	Copley Fund	All Cap Value	Unattractive
DVALX	MSS Footprints Discover Value Fund	Large Cap Blend	Very Unattractive
OTPIX	ProFunds Nasdaq 100 ProFund	Large Cap Growth	Unattractive
TILDX	Centaur Total Return Fund	Large Cap Value	Unattractive
DHMYX	Diamond Hill Small Mid Cap Fund	Mid Cap Blend	Unattractive
SPYGX	Manager Directed Spyglass Growth Fund	Mid Cap Growth	Very Unattractive
PZMIX	PPM Mid Cap Value Fund	Mid Cap Value	Very Unattractive
SLPIX	ProFunds Small Cap ProFund	Small Cap Blend	Very Unattractive
PUMYX	PACE Small Medium Growth Equity Investments	Small Cap Growth	Very Unattractive
PZSIX	PPM Small Cap Value Fund	Small Cap Value	Very Unattractive

Sources: New Constructs, LLC and company filings

ProFunds (OTPIX, SLPIX) and PPM (PZMIX, PZSIX) appear more often than any other providers in Figure 2, which means that they offer the most mutual funds with the worst holdings.

Ultimus Managers Adler Value Fund (ADLVX) is the worst rated mutual fund in Figure 2. Zevenbergen Growth Fund (ZVNIX), PACE Small Medium Growth Equity Investments (PUMYX), Manager Directed Spyglass Growth Fund (SPYGX), ProFunds Small Cap ProFund (SLPIX), PPM Small Cap Value Fund (PZSIX), MSS Footprints Discover Value Fund (DVALX), and PPM Mid Cap Value Fund (PZMIX) also earn a Very Unattractive 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 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

[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.

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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4. **Relevant** - Empirical evidence must provide tangible, quantifiable correlation to stock, ETF or mutual fund performance.

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