



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.

Get the best fundamental research

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 2.01%, which is the average total annual costs of the 682 U.S. equity Sector mutual funds we cover. The weighted average is lower at 1.25%, 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 Fidelity Real Estate Index Fund (FSRNX) is the least expensive. Rydex (RYREX, RYCRX, RYHRX) provides three of the most expensive mutual funds while Vanguard 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%
RYCRX	Rydex Real Estate Fund	Real Estate	7.38%
SBMBX	Saratoga Energy and Basic Materials	Energy	6.92%
SFPAX	Saratoga Financial Services	Financials	6.78%
RYHRX	Rydex Real Estate Fund	Real Estate	6.48%
Least Expensive			
FSRNX	Fidelity Real Estate Index Fund	Real Estate	0.09%
FESIX	Fidelity SAI Real Estate Index Fund	Real Estate	0.09%
VFAIX	Vanguard Financials Index Fund	Financials	0.12%
VINAX	Vanguard Industrials Index Fund	Industrials	0.12%
VUIAX	Vanguard Utilities Index Fund	Utilities	0.12%

Sources: New Constructs, LLC and company filings



Investors need not pay high fees for quality holdings.¹ Vanguard Financials Index (VFAIX) is the best ranked sector mutual fund in Figure 1. VFAIX's Neutral [Portfolio Management rating](#) and 0.12% total annual cost earns it a Very Attractive rating.² John Hancock Regional Bank Fund (JRGRX) is the best ranked sector mutual fund overall. JRGRX's Neutral Portfolio Management rating and 0.90% total annual cost also earns it a Very Attractive rating.

On the other hand, Fidelity Real Estate Index Fund (FSRX) 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
FIJFX	Fidelity Advisor Materials Fund	Basic Materials	Unattractive
FGKMX	Fidelity Advisor Communications Services Fund	Consumer Cyclical	Unattractive
PGLOX	T. Rowe Price Global Consumer Fund	Consumer Non-cyclical	Unattractive
IENRX	Ivy Energy Fund	Energy	Unattractive
HISFX	Hennessy Small Cap Financial Fund	Financials	Unattractive
PHLQX	PGIM Jennison Health Sciences Fund	Healthcare	Unattractive
PGWTX	Putnam Global Industrials Fund	Industrials	Unattractive
VRREX	Virtus Duff & Phelps Real Estate Securities Fund	Real Estate	Very Unattractive
PTTEX	Putnam Global Technology Fund	Technology	Unattractive
FIJGX	Fidelity Advisor Telecommunications Fund	Telecom Services	Unattractive
GAUIX	Gabelli Utilities Funds	Utilities	Unattractive

Sources: New Constructs, LLC and company filings

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

Ivy Energy Fund (IENRX) is the worst rated mutual fund in Figure 2. Fidelity Advisor Telecommunications Fund (FIJGX), PGIM Jennison Health Sciences Fund (PHLQX), Gabelli Utilities Fund (GAUIX), Putnam Global Technology Fund (PTTEX), and Virtus Duff & Phelps Real Estate Securities Fund (VRREX) 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 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.

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](#).



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.

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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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