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. The best fundamental data in the world, proven in The Journal of Financial Economics, drives our research and analysis of mutual fund holdings. We leverage this data to provide tools that can eliminate fund fees and create better asset allocations. Below, we identify three red flags you 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 1.68%, which is the average total annual cost of the 6,108 U.S. equity Style mutual funds we cover. The weighted average is lower at 0.96% which highlights how investors tend to put their money in mutual funds with low fees.

Figure 1 shows American Growth Cannabis Fund (AMREX) is the most expensive style mutual fund and iShares S&P 500 Index Fund (BSPGX) is the least expensive. American Growth (AMREX, AMRBX) and AmericaFirst (ABRFX, AFPAX) provide some of the most expensive mutual funds while Vanguard (VFFSX, VSTSX) mutual funds are among the cheapest.

Figure 1: 5 Most and Least Expensive Style Mutual Funds

Ticker	Name	Style	Total Annual Cost
Most Expensive			
AMREX	American Growth Cannabis Fund	All Cap Blend	13.32%
AMRBX	American Growth Fund Series One	All Cap Blend	11.66%
ABRFX	AmericaFirst Monthly Risk-On-Risk-Off Fund	All Cap Blend	7.19%
AFPAX	AmericaFirst Income Fund	All Cap Blend	6.67%
DADGX	Dunham Small Cap Growth Fund	Small Cap Growth	5.60%
Least Expensive			
BSPGX	iShares S&P 500 Index Fund	Large Cap Blend	0.02%
VFFSX	Vanguard 500 Index Fund	Large Cap Blend	0.02%
VSTSX	Vanguard Total Stock Market Index Fund	All Cap Blend	0.02%
FXAIX	Fidelity 500 Index Fund	Large Cap Blend	0.02%
SWPPX	Schwab S&P 500 Index Fund	Large Cap Blend	0.03%

Sources: New Constructs, LLC and company filings

Investors need not pay high fees for quality holdings.[1] iShares S&P 500 Index Fund (BSPGX) is the best ranked style mutual fund in Figure 1. BSPGX's Neutral Portfolio Management rating and 0.02% total annual cost earns it an Attractive rating.[2] SEI Institutional Global Managed Volatility Fund (SGMAX) is the best ranked style mutual fund overall. SEI Institutional Global Managed Volatility Fund's Attractive Portfolio Management rating and 0.90% total annual cost earns it a Very Attractive rating.

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
DVALX	Footprints Discover Value Fund	All Cap Blend	Very Unattractive
IALAX	Transamerica Capital Growth	All Cap Growth	Very Unattractive
LLPFX	Longleaf Partners Fund	All Cap Value	Very Unattractive
MLSAX	Aberdeen U.S. Sustainable Leaders Small Comp.	Large Cap Blend	Unattractive
PCLCX	PACE Large Co Growth Equity Investments	Large Cap Growth	Unattractive
UPDDX	Upright Growth & Income Fund	Large Cap Value	Unattractive
NEOMX	Neiman Opportunities Fund	Mid Cap Blend	Very Unattractive
SGFFX	Sparrow Growth Fund	Mid Cap Growth	Unattractive
IIVAX	Transamerica Small/Mid Cap Value	Mid Cap Value	Unattractive
SLPSX	Small-Cap ProFund	Small Cap Blend	Very Unattractive
PQUAX	PACE Small/Medium Co Growth Equity Investments	Small Cap Growth	Very Unattractive
PVFIX	Pinnacle Value Fund	Small Cap Value	Very Unattractive

Sources: New Constructs, LLC and company filings

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

The Pinnacle Value Fund (PVFIX) is the worst rated mutual fund in Figure 2. Pace Small/Medium Co Growth Equity Investments (PQUAX), Small Cap ProFund (SLPSX), Transamerica Small/Mid Cap Value (IIVAX), Sparrow Growth Fund (SGFFX), Neiman Opportunities Fund (NEOMX), Upright Growth & Income Fund (UPDDX), Longleaf Partners Fund (LLPFX), Transamerica Capital Growth (IALAX), and Footprints Discover Value Fund (DVALX) 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] Three independent studies from respected institutions prove the superiority of our data, models, and ratings. Learn more here.
[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.

This article originally published on January 29, 2021.

Disclosure: David Trainer Kyle Guske II, Alex Sword, and Matt Shuler receive no compensation to write about any specific stock, style, or theme.

Follow us on Twitter, Facebook, LinkedIn, and StockTwits for real-time alerts on all our research.

It's Official: We Offer the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Below, we present three different papers from both the public and private sectors that prove the superiority of our proprietary fundamental data, earnings models, investment ratings, and research for stocks, bonds, ETFs, and mutual funds.

Best Fundamental Data in the World

Forthcoming in The Journal of Financial Economics, a top peer-reviewed journal, Core Earnings: New Data & Evidence proves the superiority of our fundamental data, earnings models, and research. More details.

Key quotes from the paper:

- "[New Constructs'] *Total Adjustments* differs significantly from the items identified and excluded from Compustat's adjusted earnings measures. For example… 50% to 70% of the variation in *Total Adjustments* is not explained by *IBSPI Adjustments*, *OIADP Adjustments*, or *OPE Adjustments* individually." – pp. 14, 1st para.
- "A final source of differences [between New Constructs' and S&P Global's data] is due to data collection oversights…we identified cases where Compustat did not collect information relating to firms' income that is useful in assessing core earnings." – pp. 16, 2nd para.

Superior Models

A top accounting firm features the superiority of our NOPAT, Invested Capital, and ROIC research on four mega-cap companies in "Getting ROIC right: how an accurate view of ROIC can drive improved shareholder value".

Key quotes from the paper:

- "…an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [the New Constructs method] can investors get an accurate calculation of ROIC." – pp. 8, 5th para.
- "The majority of the difference…comes from New Constructs' machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies." – pp. 4, 2nd para.

See the Appendix for direct comparison of our analysis of DOW's 2015 results to Capital IQ and Bloomberg.

Superior Stock Ratings

Robo-Analysts' stock ratings outperform those from human analysts as shown in this paper from Indiana's Kelley School of Business. Bloomberg features the paper here.

Key quotes from the paper:

- "the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant." – pp. 6, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are here.

DISCLOSURES

New Constructs®, LLC (together with any subsidiaries and/or affiliates, “New Constructs”) is an independent organization with no management ties to the companies it covers. None of the members of New Constructs’ management team or the management team of any New Constructs’ affiliate holds a seat on the Board of Directors of any of the companies New Constructs covers. New Constructs does not perform any investment or merchant banking functions and does not operate a trading desk.

New Constructs’ Stock Ownership Policy prevents any of its employees or managers from engaging in Insider Trading and restricts any trading whereby an employee may exploit inside information regarding our stock research. In addition, employees and managers of the company are bound by a code of ethics that restricts them from purchasing or selling a security that they know or should have known was under consideration for inclusion in a New Constructs report nor may they purchase or sell a security for the first two days after New Constructs issues a report on that security.

DISCLAIMERS

The information and opinions presented in this report are provided to you for information purposes only and are not to be used or considered as an offer or solicitation of an offer to buy or sell securities or other financial instruments. New Constructs has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor and nothing in this report constitutes investment, legal, accounting or tax advice. This report includes general information that does not take into account your individual circumstance, financial situation or needs, nor does it represent a personal recommendation to you. The investments or services contained or referred to in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about any such investments or investment services.

Information and opinions presented in this report have been obtained or derived from sources believed by New Constructs to be reliable, but New Constructs makes no representation as to their accuracy, authority, usefulness, reliability, timeliness or completeness. New Constructs accepts no liability for loss arising from the use of the information presented in this report, and New Constructs makes no warranty as to results that may be obtained from the information presented in this report. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is made regarding future performance. Information and opinions contained in this report reflect a judgment at its original date of publication by New Constructs and are subject to change without notice. New Constructs may have issued, and may in the future issue, other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and New Constructs is under no obligation to insure that such other reports are brought to the attention of any recipient of this report.

New Constructs’ reports are intended for distribution to its professional and institutional investor customers. Recipients who are not professionals or institutional investor customers of New Constructs should seek the advice of their independent financial advisor prior to making any investment decision or for any necessary explanation of its contents.

This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would be subject New Constructs to any registration or licensing requirement within such jurisdiction.

This report may provide the addresses of websites. Except to the extent to which the report refers to New Constructs own website material, New Constructs has not reviewed the linked site and takes no responsibility for the content therein. Such address or hyperlink (including addresses or hyperlinks to New Constructs own website material) is provided solely for your convenience and the information and content of the linked site do not in any way form part of this report. Accessing such websites or following such hyperlink through this report shall be at your own risk.