

The Makings of a “Fantastic” Fund

Morningstar’s Fantastic 50 Funds List

A well-designed retirement plan needs a solid investment lineup. Many turn to independent ranking firms for unbiased investment performance, ranking, and commentary.

Each year, Morningstar’s Director of Mutual Fund Research, Russel Kinnel, constructs the Morningstar “Fantastic” list, highlighting the best of the best in the fund world. This year, Kinnel considered a universe of nearly 8,000 funds of which 50 made the cut by passing each of the following tests¹:

- ✓ Cheapest quintile of category
 - High expenses diminish returns. Studies show that funds in the cheapest quintile frequently outperform funds with higher expenses.
- ✓ Manager personally invests more than \$1million in his/her fund
 - When a manager invests a large sum of money in the fund he or she manages, that speaks a note of confidence. These funds are more likely to outperform than those without such manager ownership interest.
- ✓ Morningstar Risk rating below “High”
 - Investments with high risk can lead to bigger returns as well as bigger losses.
- ✓ Morningstar Analyst rating of “Bronze” or higher
- ✓ Fund’s Parent Firm has a “Positive” grade
- ✓ Returns above the fund’s benchmark during the manager’s tenure
 - Kinnel weeds out funds with management tenure of less than five years and insists that funds beat their benchmark for the period beginning with the earliest manager’s start date.

Kinnel uses very stringent tests designed to highlight the “fantastic” funds in the universe of investment alternatives. American Funds and Vanguard are well represented on the list with 11 funds and 10 funds, respectively, making the cut. Another well-known fund family, Fidelity is not trailing far behind with seven funds on the list.

Find the full list of the 2015 “Fantastic 50” [here](#).

How should the Fantastic 50 list or any other investment pick list affect how you select investments for your Plan’s lineup? As fiduciaries, Plan Sponsors must act prudently in selecting investment alternatives for their Plan and monitor investments on an ongoing basis. Although it would not be prudent to rely on these lists alone, they may serve as a good starting point for investment analysis. What factors should be considered in investment selection & monitoring?

¹ Kinnel, Russel. Fantastic 50. Morningstar Fund Investor. June 2015. Vol 23. Number 10.

Cost

High fees can be detrimental to participant retirement accounts. Ensure expense ratios are reasonable.

Performance

As Mr. Kinnel points out, the fund manager's tenure is a more accurate period of time to gauge the fund's returns and overall performance than using a standardized time period. Look for funds that are consistently performing in the top quartile and beating their benchmark.

Diversification

Plan sponsors are obligated to offer a range of fund alternatives with various risk/reward characteristics to provide participants the ability to develop a diversified portfolio. Considerations include number of funds, asset classes, and portfolio allocation of equities to bonds. Research has shown that 15-20 alternatives is an appropriate amount as long as they are diversified across asset classes.

For the best practices in diversification, check out our [June 2014 article](#).

Analyst's Ratings

Ratings and lists prepared by industry professionals such as Mr. Kinnel should not be the sole tool for determining your investment lineup; however they should not be disregarded. These professionals are skilled in analyzing investments and know how to pick the "fantastic" funds from the pack.