

The Makings of a Fantastic Fund

The 2016 Morningstar Fantastic Fund List

Annually, Morningstar's Director of Mutual Fund Research, Russel Kinnel, puts the universe of funds through a rigorous screening process to determine what he considers to be the best of the best. This year, only 45 funds out of nearly 8,000 passed each of Kinnel's tests to earn recognition as a "Fantastic" fund.¹

Mr. Kinnel has designed his screening process to be, in his words, "very picky and very quantitative". While the process may test for certain criteria that is not of specific importance to all Plan Sponsors, Kinnel's tests give Sponsors a springboard for evaluating investment alternatives in their own plans. Keep in mind, however, that this list is not fully exhaustive of the criteria that can or should be considered when building a fund lineup.

View the 2016 Fantastic Fund list [here](#).

Tests and the Reasoning Behind Them

To earn a spot on Kinnel's Fantastic Fund List, a fund must pass all of the following tests in the screening process.

Cheapest Quintile of Category

High expenses diminish returns. Morningstar research has shown that funds in the cheapest 20% frequently outperform funds with higher expenses.

Manager Investment of more than \$1 million in the 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 often outperform those without such manager ownership interest.

Morningstar Risk rating below "High"

High risk investments can lead to larger than average returns, but also carry the potential of significant losses. Morningstar's Risk rating assesses the variations in a fund's monthly returns, with an emphasis on downside variations, in comparison to similar funds.

Funds can receive a risk rating of Low, meaning the fund is in the lowest 10% of measured risk, Below Average (the next 22.5%), Average (the middle 35%), Above Average (the next 22.5%) or High (the top 10%).

Morningstar Analyst rating of "Bronze" or higher

As a provider of independent investment research, Morningstar provides an Analyst Rating which is a summary expression of Morningstar's forward-looking analysis of a fund. Morningstar analysts assign ratings based on their conviction in a fund's ability to

¹ The original 2016 Fantastic list, containing 48 funds, appeared in the July 2016 issue of Morningstar's FundInvestor. The data was updated as of September 13, 2016 causing three funds to be removed.

outperform its peer group and/or relevant benchmark on a risk-adjusted basis over the long term.

Funds are rated based on a five-tier scale with three positive ratings - Gold, Silver, and Bronze - as well as Neutral and Negative. A positive rating means the analysts expect the fund to outperform over a full market cycle of at least five years.

Learn more about the Analyst Rating on the [Morningstar website](#).

Parent Firm Rating of “Positive”

As Kinnel explains, “You want a good steward with a strong investment culture when you invest for the long haul.” Another proprietary data point, the Morningstar Stewardship Grade™, gauges the degree to which the fund’s parent company has its interests aligned with those of fund shareholders. Grades include an analysis of corporate culture, fund manager incentives, fees, fund board quality, and regulatory history. Parent companies obtaining an A or B stewardship grade will have an overall “Positive” Parent Rating

Inclusion of the Stewardship grade in the screening process allows Kinnel to test for significant qualitative measures in building the Fantastic List.

Outperforms Benchmark over Manager’s Tenure

First, Kinnel removes funds with manager tenure less than five years. Next, he insists that the fund beat its benchmark for a period beginning with the earliest manager’s start date to the present².

To ensure the list is usable by the vast majority of investors, Kinnel removes institutional share classes which require large minimum investments. Closed funds are not excluded from the list because investors may still have the fund in their portfolio.

The Bottom Line

Annually, Morningstar’s Russ Kinnel screens the fund universe for the best of the best. The 2016 Fantastic Fund list can be found on the [Morningstar website](#).

While Kinnel’s screening process is very stringent and can help Plan Sponsors to identify the best of the fund universe, more evaluation is needed to construct a plan’s fund lineup. Next month, we will further discuss how fund rating lists and other tools can be used to help Plan Sponsors to construct a “Fantastic” fund lineup.

² Return data through August 2016.