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Category: **Business**

Most mutual fund groups under investigation were underperformers

By **Analisa Nazareno**
Express-News Business Writer

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Names that sounded like pillars of strength and financial confidence — Strong, Putnam, Morgan Stanley and Janus — now are on the Security Exchange Commission's list of mutual funds with questionable management practices.

With SEC investigators probing more and more into mutual funds, investors have been in a fix about what to do. Take money out of a questionable mutual fund? And then what?

After listening to the cries of investors, an organization called Fiduciary Analytics compiled research on 255 mutual fund families and ranked them based on criteria including age of the fund, staff stability, assets under management and short- and long-term performance.

While the criteria don't include some significant intangibles — such as whether employees behave in an ethical manner — researchers are looking into whether there is a correlation between ethical behavior and top-scoring mutual funds.

“An overwhelming majority of (the funds the SEC is investigating) were not in the top quartile of funds,” said Donald B. Trone, the CEO of Fiduciary Analytics, a Sewlickey, Penn., consulting firm. “And the reason for that, we believe, is that ethical fund management at the entire firm, starting at the top level, has a strong correlation to long-term investment performance.”

Trone also is director of the Center for Fiduciary Studies, which is affiliated with the University of Pittsburgh's Katz Graduate School of Business.

His 10 top-ranking funds are Matthews Asian Funds, Advance Capital I Group, Bridgeway Funds, Elfun Funds, Oakmark Funds, RS Funds, TD Waterhouse Funds, Vanguard Group, Undiscovered Managers Funds and Wasatch Funds.

San Antonio-based USAA Group scored among the best funds, settling in at the

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43rd position, outranking the TIAA-CREF and Fidelity mutual fund families.

It also outranked Morgan Stanley Institutional Funds, whose chairman apologized twice because brokers failed to disclose a conflict of interest in promoting certain funds.

Janus — whose managers admitted to market-timing, or illegally buying funds at old prices and immediately selling them at newer, higher prices to make short-term gains — scored in the 103rd position.

Strong Funds, whose founder Richard Strong stepped down as CEO and chief investment officer because he allegedly profited from timed trades, ranked 123rd.

Putnam Funds, the nation's fifth-biggest fund family and accused of allowing investors to make illegal rapid trades, was 137th.

And while other scandal-tainted funds ranked similarly low, Schwab Funds and Morgan Stanley did score among the higher-ranking funds, at 23rd and 63rd.

“As good as our research is, no one should rely solely on that,” Trone said. “It's very important that you take in as much information as you can about a product or a service or fund family before making an investment.”

Trone said his clients — trust managers — called for advice after mutual funds were implicated in the market-timing and rapid-trading scandals.

“If a fund family shows up in the headlines, you have to take that into consideration,” Trone said. “If they also perform poorly in our rankings, now you have two solid pieces of information to consider. You can make a better decision than if you took one piece of information into consideration.”

He also suggested looking closely at where the questionable activity originated.

“As an individual investor, you almost cannot safeguard against this,” he said. “At some organizations, it appears that the malfeasance was done at the mid-level, as opposed to sanctioned from the top-down, as in the case with Janus.”

While mutual funds are undergoing intense scrutiny and Congress is evaluating whether to include further safeguards, a finance professor said, investors should keep cool heads.

“Mutual funds are under the microscope right now and as an investor, I would resist a knee-jerk reaction of pulling funds from one to another for many reasons, including the fact that you're going to incur costs, transactional as well as taxation costs,” Virginia Tech professor Greg Kadlec said. “People are treading pretty lightly, and I think while they're under the microscope, I would be surprised to see new evidence of these issues cropping up.”

Kadlec said another piece of information investors should consider is whether fund managers invest their own money in the portfolio.

“From this you get a sense that their interests are aligned with your own,” Kadlec said.

Trone said the majority of his funds are invested in a mixture of indexed and actively managed Vanguard Funds.

“They practice the principles that we've been talking about: putting the investor first, utilizing sound long-term investment strategies rather than chasing the latest hot investment idea, and developing sound employee relationships,” Trone said.

“They've also been more active in constructing a board of directors for the funds which are more in tune to the investors themselves and more aligned with interests of the investor than the fund company.”

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