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A New Fund-Company Order

It's time for my annual look at fund companies. I gather data on a number of key measures then roll them all up into one big ranking to see how fund companies are doing overall.

Seeing the big picture helps to assess how strong a fund company is across the board. Choosing the right fund company is as important as choosing the right fund. After all, a fund doesn't operate in a vacuum. Managers generally draw on a common pool of analysts and traders. When a manager leaves or retires, his replacement often comes from that pool. Moreover, the fund company's values, investment abilities, and time horizon all come into play over the life a mutual fund.

I have summed up fund-company results based on a few key metrics: five-year relative performance ranking, Morningstar Analyst Rating, average manager tenure, average manager investment, and \five-year retention rate. Then in each case we took that data set and turned it into a percentile rank among the 30 largest fund companies. So, the best in a column has a rank of 1, second best is 4, all the way down to 100 for the worst. We then had a figure we could average to create an overall score. Each measure is given the same weighting in our overall score.

For Analyst Rating, we assigned a 5 for Gold-rated funds, a 4 for Silver, a 3 for Bronze, a 2 for Neutral, and a 1 for Negative. It's worth noting that this is affected by which funds we cover for a fund company, though in each case we are covering their biggest and most important funds.

For average manager investment, we use the mid-point of a reported range to come up with an overall average. Thus, if a manager is reported to have invested between $100,000 and $500,000 in his fund, we would assume he had $300,000 in his fund. The five-year retention rate is a figure *FundInvestor* readers probably know well, as it debuted in these pages when I first wanted to measure how well fund companies are retaining their managers. We look at all the managers at a firm at the beginning of the year, then measure what percentage are still there at the end of the year, and then average that figure over five years. The measure was later adopted as a component of our Stewardship Grades.

In consulting and industry circles, stability of management is often considered the best measure of investment culture. If managers are heading for the exits, it usually means there are some big problems at the firm. Creating a healthy culture where very skilled and sought after investment professionals want to stay for their whole career is one of the hardest things to do in the money management world.

As you may have noticed, I made one big tweak to the data for this year's rankings. I dropped in Analyst Ratings that we didn't have a year ago in place of stewardship. Because manager investment and retention are key components of stewardship, they are rather redundant. Analyst Ratings, however, are fundamental-driven ratings of a fund's prospects and thus nicely capture investment skill and make a nice flip side to the category performance ranking, which tells you where a fund company has been.

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Ranking Fund Companies From American Funds to Goldman Sachs

Family	5-Year Cat. Perf.	Rank	Analyst Rating	Rank	Manager Tenure	Rank	Avg. Mgr. Invst ($)	Rank	5-Yr Retention	Rank	Average Score	Overall Rank
American Funds load funds	44	59	3.60	15	14.60	4	466,000	4	96.87	4	17.20	1
Dodge & Cox	55	86	5.00	1	22.06	1	1,000,000	1	98.31	1	18.00	4
T. Rowe Price	28	11	3.57	22	7.39	35	278,019	11	94.04	18	19.40	7
Franklin Templeton Investment	40	35	3.23	29	13.21	7	185,526	24	94.57	11	21.20	11
MFS	26	7	3.28	25	8.04	24	181,419	31	92.87	35	24.40	14
Vanguard	28	11	4.21	8	6.87	45	113,275	55	93.19	24	28.60	18
JPMorgan	35	24	3.00	43	6.87	45	185,550	21	93.08	31	32.80	21
Harbor	14	4	4.67	4	6.82	59	89,074	79	93.36	21	33.40	24
Legg Mason	43	52	2.74	54	8.29	21	163,072	35	94.56	14	35.20	28
PIMCO	8	1	3.59	18	5.38	86	109,059	62	90.77	48	43.00	31
GMO	34	21	NA		8.67	18	105,909	65	88.83	69	43.25	35
Dimensional Fund Advisors	47	72	4.08	11	7.39	35	20,197	93	94.73	7	43.60	38
Wells Fargo Advantage	37	28	2.45	71	7.49	31	118,138	52	91.61	41	44.60	41
American Century Investments	33	18	2.65	57	7.27	41	112,759	59	89.84	59	46.80	45
Eaton Vance	55	86	3.00	43	7.92	28	149,511	41	92.40	38	47.20	48
Invesco	42	45	3.22	32	6.76	62	206,013	18	81.09	100	51.40	52
Federated	53	79	2.40	78	10.68	11	133,145	45	91.04	45	51.60	55
Janus	48	76	3.18	36	5.05	93	451,600	7	90.72	52	52.80	59
Fidelity Investments	40	35	3.09	39	4.65	100	160,668	38	89.45	62	54.80	62
Lord Abbett	46	65	1.94	92	6.87	45	261,477	14	87.40	76	58.40	65
John Hancock	46	65	2.25	85	6.84	55	37,183	89	93.19	24	63.60	69
BlackRock	39	31	2.56	61	5.28	89	102,500	69	85.97	89	67.80	72
TIAA-CREF Mutual Funds	41	41	2.00	89	6.29	69	91,875	76	87.44	72	69.40	76
OppenheimerFunds	57	93	2.34	82	6.62	65	181,714	28	87.05	79	69.40	76
ING Retirement Funds	43	52	3.00	43	5.04	96	18,348	96	89.07	65	70.40	82
Columbia	45	62	2.44	75	5.52	82	122,759	48	83.79	96	72.60	86
Principal Funds	42	45	2.50	64	5.53	76	13,279	100	86.93	82	73.40	89
Hartford Mutual Funds	60	100	2.50	64	5.53	76	72,706	82	90.27	55	75.40	93
AllianceBernstein	58	96	1.87	96	9.17	14	42,192	86	84.98	93	77.00	96
Goldman Sachs	54	82	1.79	100	5.85	72	93,117	72	86.75	86	82.40	100

We crunched the averages on a number of key data points for each fund company and then assigned a percentile ranking. We averaged the rankings to come up with an overall ranking. The funds are ordered by that ranking. Data as of July 31, 2012. 5-year retention rate calculated based on 5 years ended July 31, 2012.

American on Top

If your main gauge of a fund company is its recent performance, I'm sure I've surprised you with results that show American Funds comes out on top—as performance hasn't been all that impressive. However, American is second out of 30 in three key measures: tenure, average manager investment, and five-year retention rate. Those results are big positives for shareholders of American, as it shows that managers aren't throwing in the towel despite sluggish returns and sizable outflows. As a result, there's the potential for solid results in the future; that's also reflected in our Analyst Ratings, which have them fifth out of 30.

For Dodge & Cox, the story is similar. It has a strong investment culture that places Dodge in first place on Analyst Ratings, tenure, average manager investment, and five-year retention rate. Take a look at how much further it is ahead of American on some of these measures. It has an average manager investment of $1 million versus $466,000 for American. Its tenure is 22 years versus 14.6, and its retention rank of 98.3% bests American's of 96.9%. Dodge had a poor showing in 2008 that has hurt its relative performance ranking and thus put it in second place.

As ever the model of consistency, T. Rowe Price is strong across the board, though well behind Dodge and American when it comes to tenure and average manager investment. T. Rowe Price has topped these rankings in the past, and it's easy to see why. It's focused on consistency and moderating risk. When a fund manager leaves, you can rarely tell the difference from the portfolio of the new manager. It really sets the standard on manager transitions. In fact, it recently announced that Preston Athey will step down from **T. Rowe Price Small-Cap Value** PRSVX in 2014! That's advance planning.

Next come Franklin Templeton and MFS, which score well across the board but don't lead the way on any key data point. Both firms boast a wide array of skill sets in different asset classes, though Franklin Templeton has been in decline on the foreign-equity side.

Following them is Vanguard, somewhat surprisingly in sixth place. If I were creating purely subjective rankings, I'd probably have Vanguard first; in fact, our Analyst Ratings have it third. It is average manager investment and manager tenure that hold Vanguard back. They are really a reflection of Vanguard's unique setup and, to me, not as worrisome as they would be at other firms. Vanguard has a lot of index funds and a lot of plain-vanilla bond funds that are nearly index funds. Vanguard understandably will have one manager running a number of them, as one can be pretty efficient with these sort of funds. If a manager is running six funds, it's tough for him to invest a large sum in each. Moreover, it's a safe bet that Vanguard's index and quasi-index fund managers are paid less than the top people at other big firms who may well draw eight-figure salaries. To put it another way, I'm not concerned by Vanguard's position on this list.

Back in the Pack

Janus certainly has fallen down this list, hasn't it? A few years ago it was threatening to move into the top echelon, but since then performance has ebbed and a number of key managers have hit the road, including some in August. Thus, category performance and manager tenure rankings are dismal for the shop that always seems to run hot and cold.

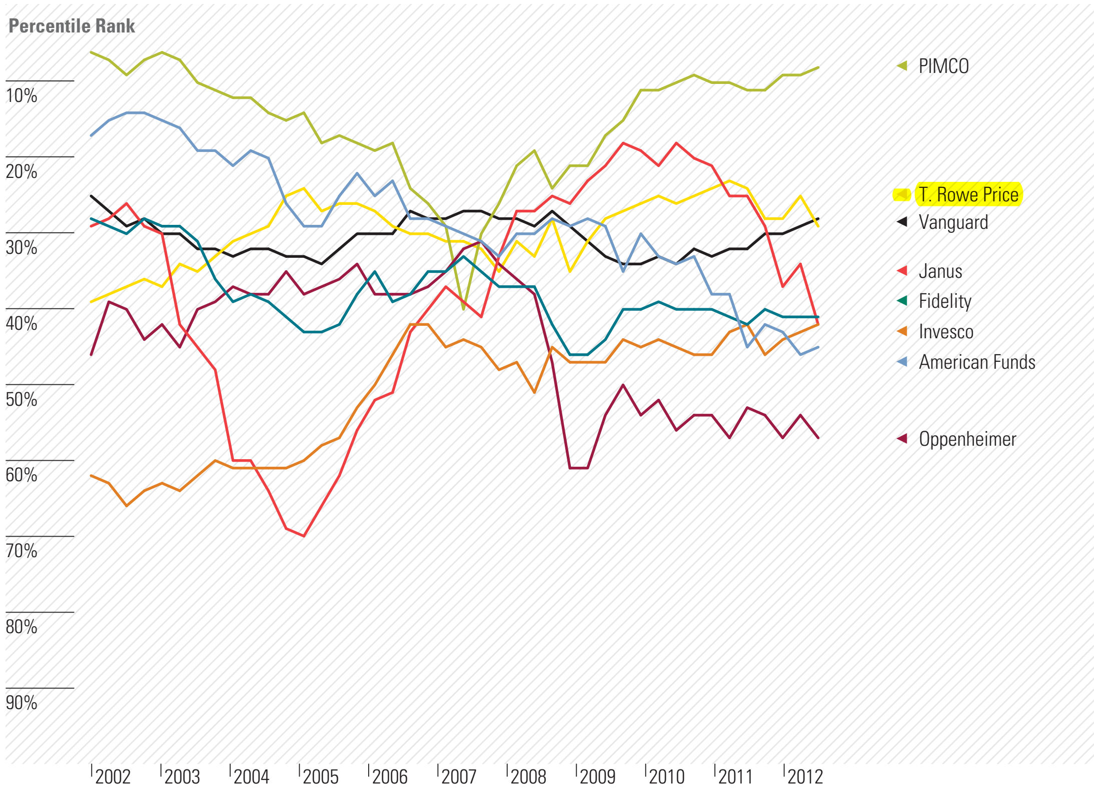
Fidelity's performance has actually picked up to a respectable level. However, it comes in last in average manager tenure and has a subpar five-year retention rate. This was partially by design, as Fidelity has switched a number of its funds to multi-manager formats where sector specialists pick within their sector. As always, there's a lot going on at Fidelity. Its bond funds are strong, while foreign stock remains unimpressive. See Page 8 for more on the state of Fidelity.

The bottom three slots go to Hartford, AllianceBernstein, and Goldman Sachs. I mentioned earlier how poor performance and low retention go hand in hand. Here you can see how that negative cycle works as good managers flee for better opportunities and weaker ones are let go for poor performance, thus leading to higher turnover than at most firms. Once that cycle starts, it's hard to stop it. Hartford took the dramatic step of moving all its funds to Wellington in response to poor results at many of the funds not run by Wellington. I suppose I'd bet on it to be the one most likely to get out of the cellar, but none of these three inspires confidence at this point.

Rolling Performance

You might notice that total return rankings are very tightly bunched with a lot of fund companies in the 40%–50% rank range. This tells me a couple of things. Because I used asset size today to screen on the 30 largest fund companies, I'm slightly nudging performance to the positive side. For example, Putnam fell out of the top 30 because of weak performance, while better-performing fund companies moved in because of inflows. In addition, larger fund companies tend to perform a little better than the universe as a whole; they have lower costs because of greater economies of scale and greater resources.

Fund Company Performance Over the Past Decade



We graphed the rolling five-year performance rankings for eight fund companies so you could see the ups and downs. We show percentile ranks where 1 is best and 100 is worst. Below 50% means that a fund company overall lagged its peers. As you can see, most on the graph did better than that. Note that some like Vanguard produced consistent outperformance while some like Janus and Oppenheimer had dramatic swings. Today, PIMCO has the best performance of those we've graphed and Oppenheimer the worst. PIMCO does have the advantage of being primarily an institutional money manager, so its fees are naturally lower and performance better. We start with rolling 5-year results from end of 2002—a period that captured both the tech stock blowout rally and subsequent collapse. You can see that T. Rowe Price and American's caution helped them to thrive in the wake of the collapse, while Vanguard's performance barely budged. Vanguard's funds collectively outperformed about 70% of its peers over nearly all the rolling periods.

Because they are so tightly bunched, I decided to take a look at how fund companies look based on this measure over time. I have graphed eight prominent fund companies' rolling five-year percentile ranks so you can get a handle on how consistent they've been. Note that some, like Janus, have had big swings, while the Vanguards of the world have been more consistent.

T. Rowe Price is likewise a very steady performer. PIMCO had a big dip but it never slid below the midpoint, meaning that collectively PIMCO's funds outperformed over the whole period.

On the other hand, you can see how more-aggressive and less-style-diverse firms like Oppenheimer and Janus had much more dramatic moves. Oppenheimer had very aggressive muni- and taxable-bond funds, and they all ran into trouble in 2008. Janus has toned down some of its aggressive tendencies, but a number of funds had India bets that hurt in 2011 and the firm has also suffered from key departures.