



How to Avoid the Worst Sector 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.

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The large number of mutual funds has little to do with serving your best interests. More [reliable](#) & [proprietary](#) fundamental data, proven in [The Journal of Financial Economics](#), drives our research and analysis of fund holdings and provides investors with a [new source of alpha](#). We leverage this data to identify three red flags you can use to avoid the worst mutual funds:

1. Inadequate Liquidity

This issue is the easiest 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.

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 1.86%, which is the average total annual costs of the 623 U.S. equity Sector mutual funds we cover. The weighted average is lower at 1.15%, which highlights how investors tend to put their [money in mutual funds with low fees](#).

Figure 1 shows Saratoga Trust Energy and Basic Materials Portfolio (SBMBX) is the most expensive sector mutual fund and Vanguard Real Estate II Index Fund (VRTPX) is the least expensive. Saratoga Trust (SBMBX, SFPAX, SEPCX, SFPCX) provides four of the most expensive mutual funds while Vanguard (VRTPX, VFAIX, VITAX, VHCIX, VINAX) mutual funds are among the cheapest.

Figure 1: 5 Most and Least Expensive Sector Mutual Funds

Ticker	Name	Sector	Total Annual Cost
Most Expensive			
SBMBX	Saratoga Trust Energy and Basic Materials Portfolio	Energy	7.57%
SFPAX	Saratoga Trust Financial Services Portfolio	Financials	6.77%
SEPCX	Saratoga Trust Energy and Basic Materials Portfolio	Energy	6.04%
RYENX	Rydex Series Energy Fund	Energy	5.77%
SFPCX	Saratoga Trust Financial Services Portfolio	Financials	5.20%
Least Expensive			
VRTPX	Vanguard Real Estate II Index Fund	Real Estate	0.10%
VFAIX	Vanguard Financials Index Fund	Financials	0.12%
VITAX	Vanguard Information Technology Index Fund	Technology	0.12%
VHCIX	Vanguard Health Care Index Fund	Healthcare	0.12%
VINAX	Vanguard Industrials Index Fund	Industrials	0.12%

Sources: New Constructs, LLC and company filings



Investors need not pay high fees for quality holdings.¹ Vanguard Financials Index Fund (VFAIX) is the best ranked sector mutual fund in Figure 1. VFAIX's Neutral [Portfolio Management rating](#) and 0.12% total annual cost earn it an Attractive rating.² Fidelity Insurance Portfolio (FSPCX) is the best ranked sector mutual fund overall. FSPCX's Attractive Portfolio Management rating and 0.96% total annual cost earns it a Very Attractive rating.

On the other hand, Vanguard Real Estate II Index Fund (VRTPX) holds poor stocks and receives our Very Unattractive rating, despite low total annual costs of 0.10%. 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 sector with the worst holdings or [portfolio management ratings](#).

Figure 2: Sector Mutual Funds with the Worst Holdings

Ticker	Name	Sector	Portfolio Management Rating
VMIAX	Vanguard Materials Index Fund	Basic Materials	Neutral
FGKMX	Fidelity Advisor Communication Services Fund	Consumer Cyclical	Unattractive
FSAVX	Fidelity Automotive Portfolio	Consumer Non-cyclical	Unattractive
FIKAX	Fidelity Advisor Energy Fund	Energy	Unattractive
FSVLX	Fidelity FinTech Portfolio	Financials	Unattractive
BHCHX	Baron Health Care Fund	Healthcare	Very Unattractive
FSDAX	Fidelity Defense and Aerospace Portfolio	Industrials	Unattractive
DFREX	DFA Real Estate Securities Portfolio	Real Estate	Unattractive
RIFYX	Victory RS Science and Technology Fund	Technology	Unattractive
TTMIX	T Rowe Price Communications & Technology Inc.	Telecom Services	Unattractive
FIKIX	Fidelity Advisor Utilities Fund	Utilities	Unattractive

Sources: New Constructs, LLC and company filings

Fidelity (FGKMX, FSAVX, FIKAX, FSVLX, FSDAX, FIKIX) appears more often than any other providers in Figure 2, which means that they offer the most mutual funds with the worst holdings.

Baron Health Care Fund (BHCHX) is the worst rated mutual fund in Figure 2. Victory RS Science and Technology Fund (RIFYX), DFA Real Estate Securities Portfolio (DFREX), Fidelity Defense and Aerospace Portfolio (FSDAX), and Fidelity Advisor Energy Fund (FIKAX) 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 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 FUNDS HOLDINGS = PERFORMANCE OF MUTUAL FUND

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](#).



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.

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1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
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Best Fundamental Data in the World

Forthcoming in [The Journal of Financial Economics](#), a top peer-reviewed journal, [Core Earnings: New Data & Evidence](#) proves our Robo-Analyst technology overcomes material shortcomings in legacy firms’ data collection processes to provide superior [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 *S&P Global’s (SPGI) 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 ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg’s in [Getting ROIC Right](#). See the [Appendix](#) for direct comparison details.

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 [as New Constructs does] 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.

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.

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