# How to Avoid the Worst Sector Mutual Funds

Question: Why are there so many mutual funds?

Answer: Mutual fund management is profitable, so Wall Street creates more products to sell.

Learn more about the best fundamental research

The large number of mutual funds has little to do with serving your best interests as an investor. 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 two red flags you can use to avoid the worst mutual funds:

**1. High Fees**

Mutual funds should be cheap, but not all of them are. The first step is to benchmark what cheap means. To ensure you are paying at or below average fees, invest only in mutual funds with total annual costs below 1.83% - the average total annual costs of the 632 U.S. equity Sector mutual funds we cover. The weighted average is lower at 1.14%, which highlights how investors tend to put their money in mutual funds with low fees.

Figure 1 shows Saratoga Trust Financial Services Portfolio (SFPAX, SFPCX) is the most expensive sector mutual fund and Vanguard Real Estate II Index Fund (VRTPX) is the least expensive. Saratoga Trust (SFPAX, SEPCX, SHPAX, STPAX) provides four of the most expensive mutual funds while Vanguard (VRTPX, VFAIX, VITAX, VMIAX, VENAX) mutual funds are among the cheapest.

**Figure 1: 5 Most and Least Expensive Sector Mutual Funds**

| Ticker | Name | Sector | Total Annual Cost |
|---|---|---|---|
| **Most Expensive** | | | |
| SFPAX | Saratoga Trust Financial Services Portfolio | Financials | 6.77% |
| SFPCX | Saratoga Trust Financial Services Portfolio | Financials | 5.20% |
| SHPAX | Saratoga Trust Health & Biotechnology Portfolio | Healthcare | 5.16% |
| STPAX | Saratoga Trust Technology & Communications Portfolio | Technology | 4.96% |
| RYREX | Rydex Real Estate Fund | Real Estate | 4.82% |
| **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% |
| VMIAX | Vanguard Materials Index Fund | Basic Materials | 0.12% |
| VENAX | Vanguard Energy Index Fund | Energy | 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 Attractive Portfolio Management rating and 0.12% total annual cost earn it a Very Attractive rating.[2] Fidelity Brokerage and Investment Management Portfolio (FSLBX) is the

[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.



Important Disclosure Information is contained on the last page of this report.
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best ranked sector mutual fund overall. FSLBX's Attractive Portfolio Management rating and 0.87% total annual cost also 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.

**2. 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 |
|---|---|---|---|
| FIJFX | Fidelity Advisor Materials Fund | Basic Materials | Neutral |
| VCDAX | Vanguard Consumer Discretionary Index Fund | Consumer Cyclicals | Neutral |
| FSAVX | Fidelity Automotive Portfolio | Consumer Non-cyclicals | Unattractive |
| PJNQX | PGIM Jennison Natural Resources Fund | Energy | Unattractive |
| FSVLX | Fidelity FinTech Portfolio | Financials | Neutral |
| MSVOX | Morgan Stanley Vitality Portfolio | Healthcare | Very Unattractive |
| FSDAX | Fidelity Defense and Aerospace Portfolio | Industrials | Unattractive |
| MNRWX | Manning & Napier Real Estate Series | Real Estate | Unattractive |
| TEFQX | Firsthand Technology Opportunities Fund | Technology | Unattractive |
| FTUIX | Fidelity Advisor Telecommunications Fund | Telecom Services | Unattractive |
| FIUIX | Fidelity Telecom & Utilities Fund | Utilities | Unattractive |

Sources: New Constructs, LLC and company filings

Fidelity (FIJFX, FSAVX, FSVLX, FSDAX, FTUIX, FIUIX) appears more often than any other provider in Figure 2, which means that they offer the most mutual funds with the worst holdings.

Morgan Stanley Vitality Portfolio (MSVOX) is the worst rated mutual fund in Figure 2. Firsthand Technology Opportunities Fund (TEFQX), Manning & Napier Real Estate Series (MNRWX), Fidelity Telecom & Utilities Fund (FIUIX), PGIM Jennison Natural Resources Fund (PJNQX), and Fidelity Defense and Aerospace Portfolio (FSDAX) 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 reflects our stock ratings of their holdings and a measure of 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 model 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. Don't just take our word for it, see what Barron's says on this matter.

PERFORMANCE OF MUTUAL FUND HOLDINGS - FEES = PERFORMANCE OF MUTUAL FUND

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 technology to get the diligence required to make prudent investment decisions.

*This article originally published on April 29, 2022.*

*Disclosure: David Trainer, Kyle Guske II, and Matt Shuler receive no compensation to write about any specific stock, sector, or theme.*

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Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our "novel database" enables investors to overcome these flaws and apply reliable fundamental data in their research.
3. Our proprietary measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

**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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We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are here.

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