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BODY:

Even though the markets continue to be about as rocky as the mountains surrounding us, many people I've talked to recently say they are slowly getting ready to venture back into mutual-fund investing.

But the question is, where to invest?

If you've been burned by your investments for three years running, you probably don't want to put more money into a fund that lost half your life savings in the first place. On the other hand, it's hard to figure out a better alternative.

For years, mutual fund research firms and finance publications, such as Morningstar, Lipper and Forbes, have offered up simple rating systems - such as grades or stars - designed to give you a shorthand summary of the fund's merits.

But here's the problem: Several pieces of research have come out recently suggesting that, boom or bust, major mutual-fund rankings systems don't necessarily do the job.

Matthew Morey, an associate finance professor at Pace University in New York, found that neither Morningstar nor Value Line showed much ability to predict which funds would do best. But, Morey wrote in the Journal of Investment Consulting, the systems did show some ability to predict the losers.

One key concern for Morey and others is that most mutual fund evaluations rely heavily on historical returns - how the fund performed in the past.

Mutual funds are always quick to caution that past performance cannot guarantee future results, but as Morey and others point out, many investors do not heed that warning. The obvious example is a high-tech fund that earns a stellar ranking after performing fabulously in the years 1998 to 2000 - only to tank in 2001 after many more people have rushed in to buy it on the merits of its superstar score.

As University of Colorado finance professor Michael Stutzer points out, another key problem is that the ratings systems can't possibly take into account each person's individual wealth, investment goals and other factors. In a recent paper, Stutzer argued, "Without more investor-specific knowledge, the best that can be hoped for is that fund ratings will partially contribute to solving investors' problems."

Mindful of such criticisms, mutual fund researchers have worked hard recently to improve their game. Chicago-based Morningstar revamped its signature star rating system last year to add much greater detail. Now, instead of clumping funds into four broad groups, the funds are compared against a much smaller group of peers. So, for example, where riskier growth funds and more conservative value funds may once have been pitted against each other, they are now judged separately, and against their peers.

Russ Kinnel, Morningstar's director of mutual fund analysis, said the original system was developed when there were a lot fewer mutual funds.

"We recognized that as the market became more stratified, (the star system) could have the contrary effect of telling people to buy high and sell low," he said.

Denver-based Lipper's system, meanwhile, has gone from simply ranking funds to assigning five different ratings based on criteria such as tax efficiencies, expense ratios and return on investments. Lipper senior analyst Don Cassidy said the system is aimed at helping people look beyond "the current fad or tilt of the market" and more toward individual investment goals.

But both Cassidy and Kinnel caution that the rating systems are - and always have been - meant simply as one of many guides in the research process. So, while the idea of a sort of investor's Cliffs Notes might sound appealing, investors must still research more deeply into the history and holdings of the fund and where it fits into their portfolios.

"I don't think there's any rating system you could come up with that's going to be a magic bullet," Kinnel said.

NOTES:

UP AND DOWN 17TH STREET;

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