The mutual fund newsletter industry has grown just as explosively as the number of mutual funds themselves. The question facing investors: Do they add value?

Newsletters That Focus On Mutual Funds: How Do They Stack Up?

By Mark Hulbert

One of the questions I'm often asked at AAII meetings is: Should you follow an investment newsletter, or invest in a mutual fund instead? This question baffles me. Why should it be an either/or choice? In fact, with more mutual funds existing today than there are individual stocks, it could be argued that a newsletter is needed by the mutual fund investor even more than the investor in individual equities.

In this article I will review the mutual fund newsletter industry, pinpointing those that have the best long-term records.

Newsletter History

The mutual fund newsletter industry has grown just as explosively as the number of mutual funds themselves. When the Hulbert Financial Digest began monitoring the newsletter industry in 1980, only a handful focused on mutual funds. A literature search I conducted on the financial press covering the late 1970s and early 1980s discovered virtually no articles that mentioned both "mutual fund" and "newsletter." The idea that newsletters might be a useful aid to the investor in choosing which mutual funds to purchase, and when, had not yet been born.

Today, in contrast, mutual fund services dominate the newsletter industry. The HFD currently tracks 477 separate newsletter portfolios, and 261—or 55%—invest exclusively in mutual funds. (An even greater number of newsletter portfolios recommend mutual funds along with securities other than mutual funds.)

Newsletter Performance

Clearly, the newsletter industry doesn't perceive an "either/or" choice between newsletters and mutual funds. The $64,000 question, however, is: Do these mutual fund newsletters add value?

To help answer this question, take a look at Table 1, which reports performance over the 10 years through June 30,1996.

The first feature that jumps out of Table 1 is how few newsletter portfolios beat a buy-and-hold over the decade. In fact, of the 27 portfolios for which the HFD has 10 years of data, only one actually did so—the "Fidelity Select Switchers" portfolio of Stockmarket Cycles. (Over the last five years, by the way, the proportion is also low, though not this low: 12, or 11%, of the 106 mutual fund newsletter portfolios over this shorter period beat a buy-and-hold.)

But this isn't the whole story. Notice in Table 1 that the majority of the mutual fund portfolios were less volatile (or risky) than the stock market as a whole. In fact, only seven (26%) were riskier. And some were very conservative indeed. For example, the "Fixed Income Bond Portfolio" of Fund Exchange incurred only 20.3% of the volatility of the Wilshire 5000. So the mutual fund newsletters as a group are at least doing a good job of reducing risk.

This points to the importance of adjusting these newsletters' performances for risk. For example, it's unrealistic to assume that a portfolio incurring just a fifth the risk of the market as a whole would even equal, much less exceed, the return of the stock market. Indeed, from this point of view it's actually quite impressive that this particular Fund Exchange portfolio came as close as it did to the stock market's return (9.94% vs. 13.12%, annualized) with such low risk.

The particular risk adjustment used in Table 1 compares a portfolio's return above the T-bill rate with its volatility. Table 1 also normalizes this ratio so that the Wilshire 5000's equals 100. On this scale, Fund Exchange's "Fixed Income Bond Portfolio" has a risk-return ratio of 254.4—which means that it did more than 2.54 times as well as the market on a risk-adjusted basis.

The number of newsletter portfolios equaling or bettering a buy-and-hold grows to seven once performance is adjusted for risk—equivalent to 26% of those newsletters for which the HFD

Mark Hulbert is editor of the Hulbert Financial Digest, a newsletter that ranks the performance of investment advisory newsletters. It is published monthly and is located at 316 Commerce St., Alexandria, Va. 22314; (703/683-5905).This column appears quarterly and is copyrighted by HFD and AAII.

Table 1.
Mutual Fund Newsletters:
Performance Over 10 Years (Through 6/30/96)

Newsletter	Portfolio	10-Year Annual Return (%)	Risk* (Wilshire =100)	Risk-Return Ratio** (Wilshire =100)
Stockmarket Cycles	Fidelity Select Switchers	16.50	88.2	150.6
**NoLoad Fund*X	Class 3: Higher Quality Growth Funds	12.49	89.9	100.0
Fabian Premium Investment Resource	Equity/Cash Switch Plan	11.30	85.8	87.5
**NoLoad Fund*X	Class 2: Speculative Growth Funds	11.09	110.8	73.1
InvesTech Mutual Fund Advisor		10.76	54.7	115.6
The No-Load Fund Investor	Wealth Builder Portfolio	10.70	96.2	75.0
The No-Load Fund Investor	Pre-Retirement Portfolio	10.60	74.5	88.8
Mutual Fund Forecaster	Trader's Corner Portfolio	10.42	107.5	66.9
Fund Exchange	Gold Portfolio	10.39	141.7	57.5
Fund Exchange	Fixed Income Bond Portfolio	9.94	20.3	254.4
Fabian Premium Investment Resource	International Funds/Cash Switch Plan	9.53	81.1	67.5
The Mutual Fund Letter	Growth & Income Portfolio	9.26	42.7	106.9
United & Babson Investment Report	Aggressive Growth Funds	9.21	111.6	53.1
Fund Exchange	Aggressive Growth Margined Portfolio	9.09	131.4	48.1
The Mutual Fund Letter	Global Growth Portfolio	8.78	67.2	65.6
United & Babson Investment Report	Income - Taxable Funds	8.50	30.4	116.3
Mutual Fund Investing	Growth Portfolio	8.39	42.5	83.1
United & Babson Investment Report	Growth Funds	8.35	95.8	47.5
Peter Dag Portfolio Strategy and Mgmt.	Vanguard No-load Model Portfolio	8.14	30.2	102.5
United & Babson Investment Report	Growth & Income Funds	8.04	80.4	47.5
Fund Exchange	Conservative Growth Margined Portfolio	7.96	91.7	43.1
Fabian Premium Investment Resource	Gold/Cash Switch Plan	7.82	135.8	36.9
The Mutual Fund Letter	Income Plus Portfolio	7.66	30.2	83.1
Fund Exchange	Aggressive Growth Portfolio	7.59	64.2	46.3
**NoLoad Fund*X	Class 1: Most Speculative Growth Funds	7.32	162.0	35.6
Mutual Fund Investing	Growth with Income Portfolio	7.31	25.7	86.3
Fund Exchange	Growth/Income Portfolio	6.81	49.1	36.3
Wilshire 5000 Value-Weighted Total Return		**13.12**	**100.0**	**100.0**

**As measured by standard deviation, the amount by which most returns varied around the average, on a scale where the Wilshire 5000 = 100.*
***As measured by the Sharpe Ratio, the return above T-bills relative to volatility, on a scale where the Wilshire 5000 = 100.*

has a decade of data. (Over the trailing five-year period, by the way, the proportion beating the market on a risk-adjusted basis is 19%.) These percentages are similar to those that prevail for mutual funds themselves.

Morningstar and Value Line

Absent from Table 1 are Morningstar Mutual Funds and the Value Line Mutual Fund Survey, the two best-known—and most comprehensive—mutual fund ranking and monitoring services. This is because neither service has been in existence for the full 10 years. However, I want to report what performance data the HFD does have for these two services.

The HFD began tracking Morningstar Mutual Funds in 1991. Initially, this service segregated its list of five-star (highest-ranked) funds into two categories, equities and fixed income. In early 1993, however, Morningstar began segregating the list into nine categories (five in equities and four in fixed-income). In order to obtain a continuous data series extending back to the beginning of 1991, I constructed two composites out of the performances of the more recent categories and chained them together with the performances of the earlier lists. [While I report performance back to 1991 in the text, note that Table 2 covers only the more recent categories and performance for comparison with Value Line].

From the beginning of 1991 through June 30, 1996, on this basis, Morningstar's highest-ranked equity funds produced a 10.9% annualized return, in contrast to 17.7% for the Wilshire 5000. This underperformance cannot be explained by below-market

Table 2.
Morningstar Mutual Funds and the Value Line Mutual Fund Survey
Performance: 1/1/94 to 6/30/96

Newsletter Portfolio	Total Annual Return (%)	Risk* (Wilshire =100)	Risk-Return Ratio** (Wilshire =100)
Morningstar Mutual Funds			
(Average of portfolios)	6.71	74.2	21.6
Higher-Risk Stock Funds	15.85	158.0	57.7
Medium-Risk Stock Funds	11.36	122.8	43.3
Lower-Risk Stock Funds	10.93	93.9	52.9
Hybrid Funds	7.79	68.7	33.7
Specialty Bond Funds	2.56	53.6	–33.7
Corporate Bond Funds	4.55	36.5	–7.2
Government Bond Funds	3.32	46.1	–26.5
International Stock Funds	–2.75	123.6	–48.1
The Value Line Mutual Fund Survey			
(Average of portfolios)	5.87	85.9	12.0
Highest Ranked General Equity	8.52	97.6	31.3
Highest Ranked International Equity	3.90	98.5	–4.8
Highest Ranked Partial Equity	6.61	79.2	19.2
Highest Ranked Special Equity	11.92	136.2	43.3
Highest Ranked Taxable Fixed Income	–1.53	59.9	–89.0
Wilshire 5000 Value Weighted Total Return Index	**17.72**	**100.0**	**100.0**

**As measured by standard deviation, the amount by which most returns varied around the average, on a scale where the Wilshire 5000 = 100.*
***As measured by the Sharpe Ratio, the return above T-bills relative to volatility, on a scale where the Wilshire 5000 = 100.*

risk, since this equity-fund composite incurred almost the same amount of risk as the Wilshire.

Morningstar's record in the fixed-income arena is better. According to the HFD, Morningstar's highest-ranked bond funds produced a 4.9% annualized return over this 5½-year period, which contrasts with an 8.2% annualized return for the Shearson Lehman Treasury index (a composite of all U.S. government bonds of at least one-year of maturity). However, Morningstar's highest-ranked bond funds were 37% less risky than the index, which means that the service's performance on a risk-adjusted basis comes closer to equaling a buy-and-hold.

The HFD's data for the Value Line Mutual Fund Survey extends back just to the beginning of 1994. Table 2 presents data for this newsletter's several portfolios over this 2½-year period, along with comparable data for the various portfolios of Morningstar Mutual Funds. In general over this 30-month period, Morningstar outpaces Value Line in the domestic arena (for both equity and fixed-income funds), with the opposite holding true in the case of international equity funds.

To be sure, part of these two services' market-lagging performances can be traced to the fact that the HFD takes sales commissions into account. This ends up being a significant drag on their returns, since both Morningstar and Value Line have many load funds on their list of highest-ranked funds, and both have fairly high turnover rates. Nevertheless, the HFD calculates that both Morningstar's and Value Line's performances still would have lagged the market even if loads hadn't been taken into account.

Conclusion

The bottom line? Mutual fund newsletters have found it difficult over the last decade to make more money than an index fund. However, they have done a creditable job of reducing the volatility otherwise associated with a buy-and-hold strategy. How important is reducing volatility? It depends on your time horizon. If you're investing for the long term, volatility along the way is of relatively little concern. To the extent your focus is the short term, however, volatility is paramount. And in such a case, it's more likely that a mutual fund newsletter can help.