

Morningstar gives just six fund families an "A" for stewardship

By Editor Test Wed, Mar 30, 2011

The results of Morningstar's 2011 Mutual Fund Stewardship Grade Research Study are in.

Morningstar, Inc. released the findings from its [2011 Mutual Fund Stewardship Grade research study](#), which evaluated more than 1,000 funds from more than 40 fund families on how well each fund treats its fund shareholders' capital.

The study calculated an average Stewardship Grade for all of the funds it grades within 44 different fund families. Six fund families currently earn an average overall Stewardship Grade of "A": American Funds, Clipper, Davis, Diamond Hill, Dodge & Cox, and PRIMECAP.

Average overall Stewardship Grades of "B" are assigned to another 16 fund families, and 17 fund families receive "C" grades. Five fund families receive "D" grades in the report. No fund family currently receives an average overall Stewardship Grade of "F."

Grades assigned to fund families by Morningstar, Inc.			
"A"	"B"	"C"	"D"
American Funds	Bridgeway	Allianz	Alliance Bernstein
Clipper	FPA	Artisan	ING
Davis	Franklin	Aston	John Hancock
Diamond Hill	Harbor	BlackRock	Principal
Dodge & Cox	Invesco	Columbia	Putnam
PRIMECAP	Janus	DWS	
	JPMorgan	Federated	
	Longleaf	Fidelity	
	MFS	Legg Mason	
	Osterweis	Neuberger Berman	
	Perkins	Oppenheimer	
	Royce	PIMCO	
	T. Rowe Price	RiverSource	
	Thornburg	Sentinel	
	Vanguard	TCW	
	Weitz	TIIA-CREF	

Source: Morningstar Inc.'s 2011 Mutual Fund
Stewardship Grade Research Paper

The study looked at how funds have performed since Morningstar first issued its Stewardship Grades in 2004 and again after the company revised its Stewardship methodology in 2007.

It concluded that funds with high Stewardship Grades (those receiving grades of "A" or "B") are very likely to survive in the long-term, and more likely to provide competitive risk-adjusted returns in the ensuing period.

For purposes of the study, funds are considered successful if they have a Morningstar Rating of three stars or higher, a metric that broadly measures whether a fund's shareholders have fared well relative to peer funds on a risk-adjusted basis. Funds were deemed unsuccessful if they received a Morningstar Rating of two stars or lower or if the funds did not survive.

Morningstar uses five major criteria to arrive at a Stewardship Grade: the corporate culture of a fund's parent organization; the quality of the board of directors overseeing the fund; the fund managers' financial incentives; the fund's fees; and the fund firm's regulatory history.

Morningstar analysts assign each component an individual grade, and combine the scores to provide an overall Stewardship Grade. Funds that are determined to be the best stewards of capital receive an "A" grade, while the worst receive an "F." Morningstar currently assigns Stewardship Grades to more than 1,000 of the approximately 1,750 funds that its analysts actively follow.

The study found that of the funds Morningstar graded in 2004 and 2007:

- About 99% of funds that received "A" Stewardship Grades survived.
- More than 80% of the funds earning grades of "A" or "B" in 2007 had competitive risk-adjusted returns relative to their peers.
- Approximately one-third of funds receiving an "F" grade in 2004 didn't survive to today.
- About one-quarter of funds receiving a "D" grade were liquidated or merged away.

Other positive correlations include:

- Approximately 87 percent of funds that earned "A" grades for corporate culture in 2007 were successful in the ensuing period;
- Managers who have their own financial incentives aligned with fund shareholders had good results—more than 75 percent of the equity funds earning "A" grades in 2007 in the manager-incentive category were successful in the ensuing period;
- Funds with low fees had the best risk-adjusted returns, primarily over long-term periods.

Among all current fund evaluations, the most common Stewardship Grade is a "C," which Morningstar assigns to 455 funds. On the high end of the scale, 90 funds currently earn an "A" overall grade and 359 funds receive a "B." On the lower end, 145 funds currently receive a "D," and just two funds receive an overall Stewardship Grade of "F."

Morningstar assigns Stewardship Grades only to funds that Morningstar analysts actively follow, meaning an analyst reviews and writes an analysis on the fund at least once per year. Every one to two years, the analysts review and update the Stewardship Grades for the families’ funds that are listed below.

The overall grades are based on the sum of the points associated with each of the five methodology areas: corporate culture, board quality, manager incentives, fees and regulatory history. The maximum Stewardship Grade score is 10 points, with corporate culture contributing up to 4 points; board quality, manager incentives, and fees each contributing up to 2 points; and regulatory history contributing up to 0 points but as low as negative 2 points for funds with poor regulatory histories.