

28 Terrific Funds

Fund Spy | 09-04-2018 | by Russel Kinnel - Director of Manager Research for Morningstar

It's time once more for my annual screen for fantastic funds. With just a few key screens, I pared down the universe of more than 8,000 mutual funds to just 28.

The final number changes a bit each year depending on how many funds pass all the tests. With so many funds, you can be very choosy. It's a purely quantitative test—I don't make exceptions just because I like a fund.

Here are the screens:

Cheapest quintile of broad level category groupings.

Morningstar studies show that funds in the cheapest quintile are a much better bet than higher-cost funds, so this is the first test and a pretty good first screen in general. I've used the broad level category groupings, which sometimes include just one category and sometimes add a few that should have similar prices together. For example, all large-cap U.S. equity funds are in one grouping. Others like bank loan or convertibles are by themselves because there are no comparable categories. In the past I just used categories. Moving to category groupings knocked a few funds out of the box mostly on the growth side because growth funds tend to charge a little more than value. It also bounced a couple sector funds that would have passed otherwise.

Manager investment of more than \$1 million in the fund.

We've found that funds in which at least one manager has invested more than \$1 million of his own money are more likely to outperform than those without such alignment of interest. The \$1 million and up bracket is as high as the SEC's brackets go, unfortunately.

Morningstar Risk rating below the High level. Our Morningstar Investor Return studies have found that highly

volatile funds are harder for investors to hold, and investor returns tend to trail total returns by a greater margin in those funds.

Morningstar Analyst Rating of Bronze or higher. This fundamental, forward-looking rating factors in qualitative and quantitative measures. So only funds recommended by Morningstar analysts make the grade.

Parent rating of Positive. You want a good steward with a strong investment culture when you invest for the long haul. The longer you invest, the more you realize how important this is.

Returns above the fund's benchmark over the manager's tenure. Rather than looking at a standardized time period, look at the period of the manager's tenure. I start with the start date of the longest-tenured manager on a team and insist that the fund beat the benchmark over that time period. I used returns through July 2018. There is a minimum five-year manager tenure, too, to weed out those with less meaningful track records.

Category benchmark for allocation categories. Many balanced funds have one equity benchmark and one bond benchmark rather than a blend of the two. That means they have either a very high or very low bar depending on which is the primary benchmark. Our category benchmarks are blended mixes of stocks and bonds, which makes them a better fit. In a few cases, I used category averages because the index returns didn't go back far enough.

No institutional share classes. I exclude these to help you get a list you can use. (I allow funds called institutional if the minimum investment is \$25,000 or less.)

No funds of funds. The screens just won't work as well with this type.

Closed funds are not screened out. Many people still own them and want to know if they still make the grade.

This year, 28 funds passed the test. For a change, I thought I'd review in the order of their margin of victory versus their benchmark. Be forewarned that awesome performance draws assets and spurs funds to close if they are run by good stewards.

	Category	Start Date	Fund Annized Ret%	Cat Annized Ret%	Index Annized Ret%	Diff vs Index
American Funds Cap Inc Bldr CAIBX	World Allocation	1/31/1992	8.68	5.05	3.88	4.80
T. Rowe Price New Horizons PRNHX	Small Growth	3/31/2010	18.66	14.19	14.19	4.47
Amer Funds CapWrldGR&Inc CWGIX	World Large Stock	3/31/1993	10.66	6.43	6.77	3.89
Fidelity Low-Priced Stock FLPSX	Mid-Cap Value	12/31/1989	13.73	11.50	9.91	3.82
American Funds New Persp ANWPX	World Large Stock	12/31/2000	8.02	4.93	5.41	2.61
Vanguard PrimeCap VPMCX	Large Growth	6/30/1985	13.54	10.82	10.99	2.54
Vanguard Explorer VEXPX	Small Growth	2/28/1994	10.11	7.93	7.93	2.18
Fidelity Asset Manager 20% FASIX	Alloc--15%-30% Eq	6/30/2009	5.41	4.64	3.44	1.98
Vanguard Wellesley Inc VWINX	Alloc--30%-50% Eq	1/31/2007	6.62	5.13	5.13	1.49
Fidelity New Millennium FMILX	Large Blend	7/31/2006	10.30	9.21	9.10	1.20
Vanguard Equity Income VEIPX	Large Value	12/31/2003	9.12	8.04	8.04	1.08
Vanguard Windsor VWNDX	Large Value	6/30/2008	9.84	8.84	8.84	1.00
T. Rowe Price Mid-Cap Val TRMCX	Mid-Cap Value	12/31/2000	10.77	9.79	9.79	0.98
Vanguard PrimeCap Core VPCCX	Large Growth	12/31/2004	11.00	10.06	10.06	0.94
Baird Core Plus Bond BCOIX	Interm-Term Bond	9/30/2000	5.65	4.66	4.94	0.71
Vanguard Dividend Growth VDIGX	Large Blend	2/28/2006	9.51	8.88	8.88	0.63
Baird Aggregate Bond BAGIX	Interm-Term Bond	9/30/2000	5.16	4.66	4.66	0.49
Dodge & Cox Income DODIX	Interm-Term Bond	1/31/1989	6.57	6.09	6.09	0.48
Amer Funds Wash Mutual AWSHX	Large Value	7/31/1997	7.75	7.48	7.25	0.47
Vanguard Selected Value VASVX	Mid-Cap Value	3/31/1999	10.33	10.03	10.03	0.30
Amer Funds American Bal ABALX	Alloc--50%-70% Eq	1/31/1997	8.24	7.16	8.13	0.11
T. Rowe Price Capital App PRWCX	Alloc--50%-70% Eq	6/30/2006	9.17	6.38	9.09	0.07
Amer Funds InvmtCo ofAmer AIVSX	Large Blend	3/31/1992	9.90	9.97	9.85	0.05
Amer Funds IncFund ofAmer AMECX	Alloc--70%-85% Eq	1/31/1992	8.84	8.46	9.76	-0.92
Vanguard Wellington VWELX	Alloc--50%-70% Eq	12/31/2002	8.87	7.75	9.98	-1.10
Mairs & Power Balanced MAPOX	Alloc--50%-70% Eq	1/31/2006	7.26	6.22	8.78	-1.52
American Funds Global Bal GBLAX	World Allocation	2/28/2011	6.32	6.11	7.95	-1.63
Fidelity Balanced FBALX	Alloc--50%-70% Eq	9/30/2008	9.64	7.45	11.75	-2.11

- source: Morningstar Analysts

American Funds Capital Income Builder (CAIBX)

480 basis points annualized above benchmark
 This fund puts the firm's global reach to good use. This Silver-rated fund includes a bond stake that accounts for about 25% of assets. American Funds are now available in No Transaction Fee networks as well as the traditional advisor-sold ones.

T. Rowe Price New Horizons (PRNHX)

446 basis points annualized above benchmark
 Good things are clearly happening on T. Rowe Price's growth team. Henry Ellenbogen has proved to be a step ahead of the competition on fast-growing small companies, including some that were private when he first invested in them. Given the fund's massive \$25 billion asset base, I doubt it will be opening in the near future.

American Funds Capital World Growth & Income (CWGIX)

389 basis points annualized above benchmark
 This fund earns a Gold rating owing to its skill plying a strategy that is somewhere between equity-income and dividend growth. The managers aim for a before-fee yield near that of the MSCI All-Country World Index, and that seems to have steered away from the more treacherous territory of higher-yielding stocks.

Fidelity Low-Priced Stock (FLPSX)

381 basis points annualized above benchmark
 Joel Tillinghast pulls off the near impossible by generating strong returns with a sprawling portfolio and huge asset base. It's an impressive feat.

American Funds New Perspective (ANWPX)

261 basis points annualized above benchmark
 Yes, it's another global equity from American offering strong management and low expenses.

Vanguard Primecap (VPMAX)

254 basis points annualized above benchmark
 No, it doesn't have the greatest outperformance of the Primecap family, but it has the longest track record, going

back 33 years. Although the last of the original founders figures to retire fairly soon, Primecap has done a good job of hiring analysts and managers to keep the firm hitting on all cylinders.

Vanguard Explorer (VEXPX)

213 basis points annualized above benchmark
 This fund lacks the management stability of the above funds. It seems to have been constantly changing subadvisors, though that has ebbed of late. Still, Vanguard's cost advantage and some decent subadvisors have kept the fund ahead of the curve.

Fidelity Asset 20% (FASIX)

198 basis points annualized above benchmark
 Fidelity has an excellent taxable-bond team, and that's apparent in a fund like this that features 20% in stocks with the rest in bonds and cash. The core bond portfolio in this fund is run by the team that runs Silver-rated Fidelity Investment Grade Bond ETF (FBNDX). (Although this is similar to a funds of funds, it actually owns the underlying securities directly, so technically it is not a fund of funds.)

Vanguard Wellesley Income (VWINX)

149 basis points annualized above benchmark
 There are few better bargains in mutual funds than this fund, which charges just 0.22% for Investor shares and 0.15% for Admiral. Subadvisor Wellington has deeply skilled teams to run the value-oriented equity portfolio and the high-quality bond portfolio. It really shows the benefits of simplicity.

Fidelity New Millennium (FMILX)

119 basis points annualized above benchmark
 John Roth's record here since 2006 is outstanding despite a pedestrian three-and five-year record. The reason it has lagged lately is that he likes cyclical value plays more than most of his large-blend peers. At a time of FAANG (Facebook, Amazon.com, Apple, Netflix, and Google [Alphabet]) dominance, being underweight tech and overweight energy is a lonely place. Still, the fact that he is ahead of the S&P 500 indicates he has some skill as a stock-picker even if not a sector rotator.

Vanguard Equity-Income (VEIPX)

108 basis points annualized above benchmark
Under lead manager Michael Reckmeyer, the fund has been a steady performer. Reckmeyer and his team at Wellington run two thirds of the portfolio, and Vanguard's quantitative equity group runs the other third. That expertise comes at the cost of just 0.26% in fees.

Where Are the Rest of Primecap and Dodge & Cox?

Primecap and Dodge & Cox funds have been mainstays of these lists over the years, but fewer made the cut this year. In most cases, it was the risk rating that tripped them up. Quite a few from Dodge & Cox and Primecap have high overall Morningstar Risk ratings and thus did not pass all the tests. But as you can see from our Analyst Ratings, we do still have a high opinion of them.

Glossary

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The Morningstar Analyst Rating (i) should not be used as the sole basis in evaluating a fund, (ii) involves unknown risks and uncertainties which may cause Analyst expectations not to occur or to differ significantly from what they expected, and (iii) should not be considered an offer or solicitation to buy or sell the fund.

Morningstar FundInvestor

In this analysis, Morningstar evaluates funds based on a set of screens established by Russel Kinnel, director of

fund research and editor. As listed on p. 1 of the article, the screens applied are as follows: (1) Expenses must be in the cheapest quintile of the category; (2) manager investment in the fund must be more than \$1,000,000; (3) the Morningstar Risk rating must be below the High level; (4) the fund must be a "medalist"—i.e., it must be rated Bronze, Silver or Gold; (5) Parent Rating must be positive; (6) the fund must have outperformed its prospectus benchmark over the tenure of the longest tenured manager. A minimum of five years is required. For funds in allocation categories, the category benchmark was used in place of the prospectus benchmark; (7) category benchmarks or averages used for allocation categories; (8) no institutional share classes; (9) no fund of funds; (10) closed funds are screened out

The test was run using returns through July 2018. Using these ten screens, the tool filtered 28 out of more than 8,000 mutual funds.

Morningstar Manager Return

A fund's annualized return from the start date (the first day of the month shown) of the longest tenured manager.

Morningstar Parent Rating

An assessment of the parent organization. Key (operational) areas of evaluating a parent organization include: recruitment and retention of talent, organizational structure, capacity management, organizational and business strategy, alignment of interests with fund investors and regulatory compliance.

Morningstar Risk

An assessment of the variations in a fund's monthly returns, with an emphasis on downward variation. It is calculated as the difference between Morningstar Return (adjusted for loads and excess over the risk-free rate) and Morningstar Risk-Adjusted Return (adjusted for loads, excess over the risk-free rate and risk). Morningstar Risk is similar to (and correlated with) standard deviation; the key difference is that standard deviation gives the same weight to upside and downside variation. Morningstar Risk is measured for up to three periods (three, five and 10 years).

For each period, all funds in a category are ranked by Morningstar Risk. The top 10% are given a risk score of 5, or "High"; the next 22.5% are scored 4, or "Above Average"; the next 35% are scored 3, or "Average"; the next 22.5% are scored 2, or "Below Average"; the bottom 10% are scored 1, or "Low."

Figures shown are past results for Class A shares and are not predictive of results in future periods. Current and future results may be lower or higher than those shown. Share prices and returns will vary, so investors may lose money. Investing for short periods makes losses more likely. Fund results are for Class A shares and reflect deduction of the 5.75% maximum sales charge. For current information and month-end results, visit americanfunds.com.

Results as of September 30, 2018

Fund	Inception Date	Average Annual Total Returns (%)				Expense Ratio (%)
		1 Year	5 Years	10 Years	Lifetime	
Growth Funds						
New Perspective Fund®	3/13/73	6.95	9.64	9.89	12.18	0.75
Growth-and-Income Funds						
Capital World Growth and Income Fund®	3/26/93	0.63	6.86	7.42	10.30	0.77
The Investment Company of America®	1/1/34	6.94	11.01	10.12	12.08	0.58
Washington Mutual Investors Fund SM	7/31/52	7.38	10.89	10.07	11.81	0.57
Equity-Income Funds						
Capital Income Builder®	7/30/87	-4.90	4.29	5.71	8.85	0.59
The Income Fund of America®	12/1/73	-1.09	6.29	7.75	10.77	0.55
Balanced Funds						
American Balanced Fund®	7/26/75	2.61	7.93	8.70	10.52	0.57
American Funds Global Balanced Fund SM	2/1/11	-3.27	3.93	-	5.28	0.86

Investment results assume all distributions are reinvested and reflect applicable fees and expenses. Expense ratios are as of each fund's prospectus available at the time of publication. When applicable, investment results reflect fee waivers and/or expense reimbursements, without which results would have been lower. Please see americanfunds.com for more information.

Investing outside the United States involves risks such as currency fluctuations, periods of illiquidity and price volatility, as more fully described in the prospectus. These risks may be heightened in connection with investments in developing countries. The return of principal for bond funds and for funds with significant underlying bond holdings is not guaranteed. Fund shares are subject to the same interest rate, inflation and credit risks associated with the underlying bond holdings. Lower rated bonds are subject to greater fluctuations in value and risk of loss of income and principal than higher rated bonds.

If used after December 31, 2018, this article must be accompanied by a current American Funds quarterly statistical update.

Investors should carefully consider investment objectives, risks, charges and expenses. This and other important information is contained in the fund prospectuses and summary prospectuses, which can be obtained from a financial professional and should be read carefully before investing.

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