

# Equity Fund Selection

**YT Kum, CFA, Senior Research  
Analyst**

**MORNINGSTAR<sup>®</sup>**

# Challenges to Equity Fund Investing

- ▶ Difficult to add alpha.
- ▶ Challenges from ETFs.
- ▶ Lack of detailed information for fundamental analysis.

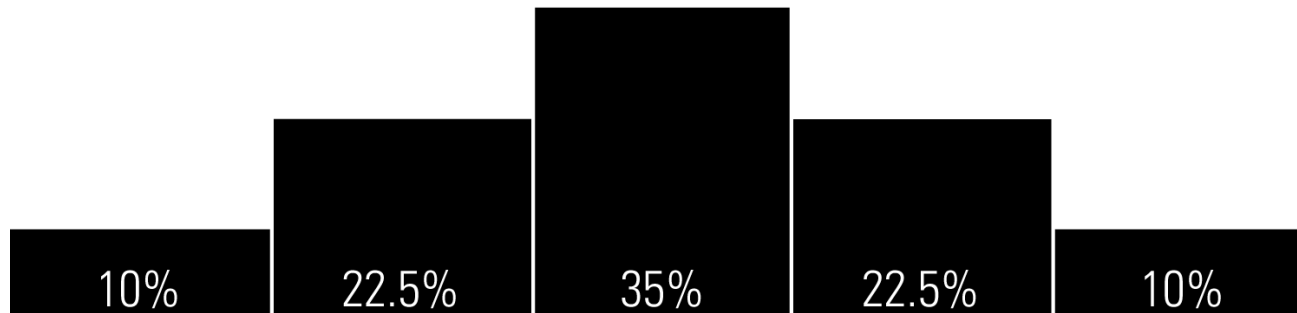
# Equity Fund Analysis (Part 1)

*What should we do if we cannot perform  
fundamental analysis?*

- ▶ Screening
- ▶ Return Analysis
- ▶ Risk Analysis
- ▶ News Analysis

# Screening: Morningstar Rating

- ▶ The peer group for each fund's rating is its Morningstar Category
- ▶ Ratings are based on fund's risk adjusted returns
- ▶ Morningstar Risk penalizes more on the downside risk



# Screening: Total Expense Ratio (TER)

- ▶ Cheap funds tend to perform well

# Return Analysis: Return Patterns

*Which areas investors should pay attention to?*

- ▶ Calendar Year Performance
- ▶ Upside/downside Capture Ratio
- ▶ Tracking Error

# Return Analysis: Return Patterns

*How did the fund perform in ups and downs?*

▶ Upside/downside Capture Ratio

Downside Capture Ratio measures manager's performance in down markets. A down-market is defined as those periods (months or quarters) in which market return is less than 0. In essence, it tells you what percentage of the down-market was captured by the manager. For example, if the ratio is 110%, the manager has captured 110% of the down-market and therefore underperformed the market on the downside.

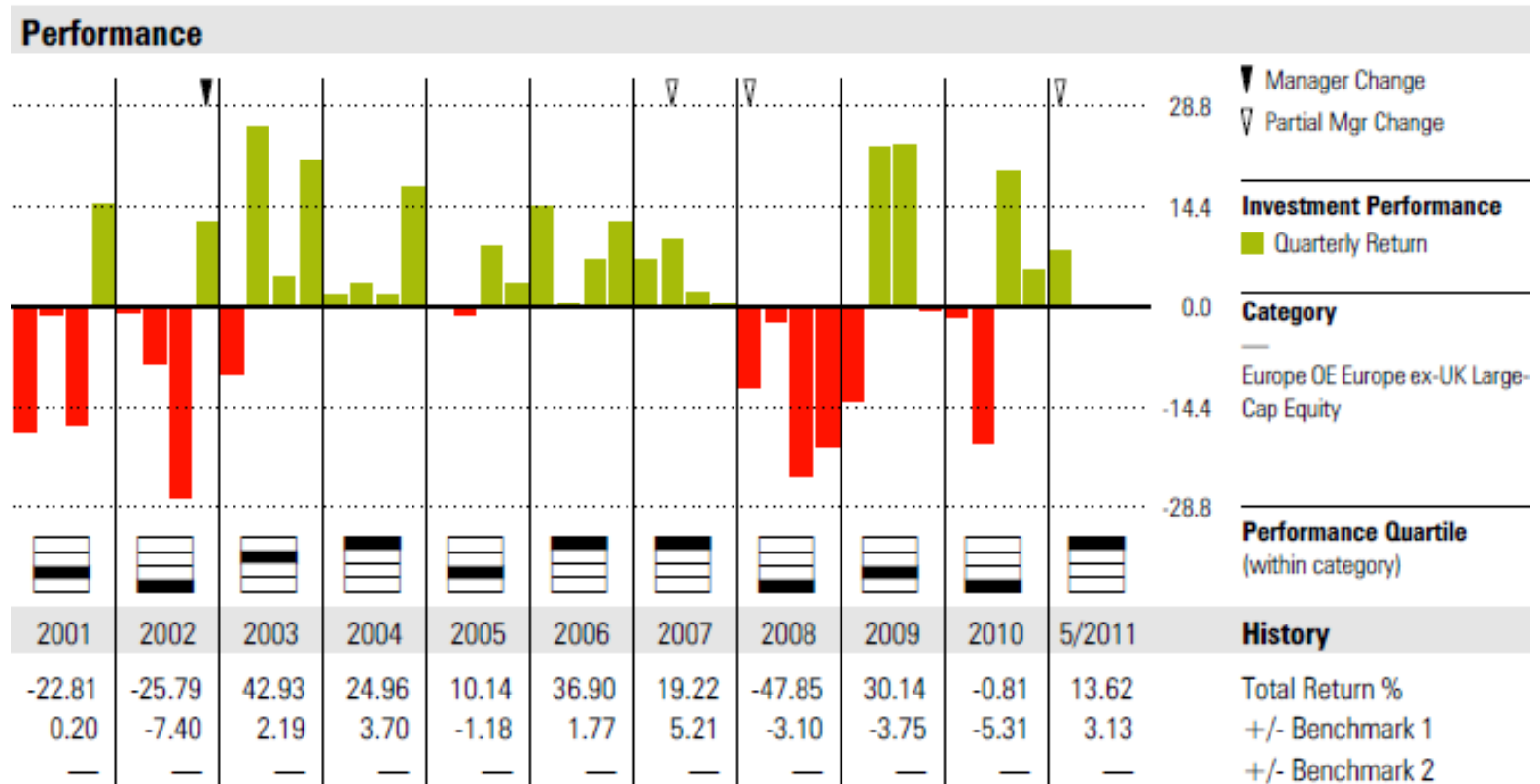
# Return Analysis: Return Patterns

## **CASE STUDY**



# Return Analysis: Return Patterns

## ▶ Case 1



# Return Analysis: Return Patterns

▶ Case 1

<b>Relative Performance</b> 6/1/2006 to 5/31/2011		
	Bmark 1	Bmark 2
Excess Return	-0.78	—
Alpha	-0.50	—
Beta	1.07	—
R-Squared	98.17	—
Tracking Error	3.88	—
Information Ratio	-0.20	—
Treynor Ratio	-0.14	—
.....		
Up Capture Ratio	105.89	—
Down Capture Ratio	108.42	—
Up Number Ratio	0.94	—
Down Number Ratio	0.88	—
Up Percentage Ratio	0.62	—
Down Percentage Ratio	0.35	—



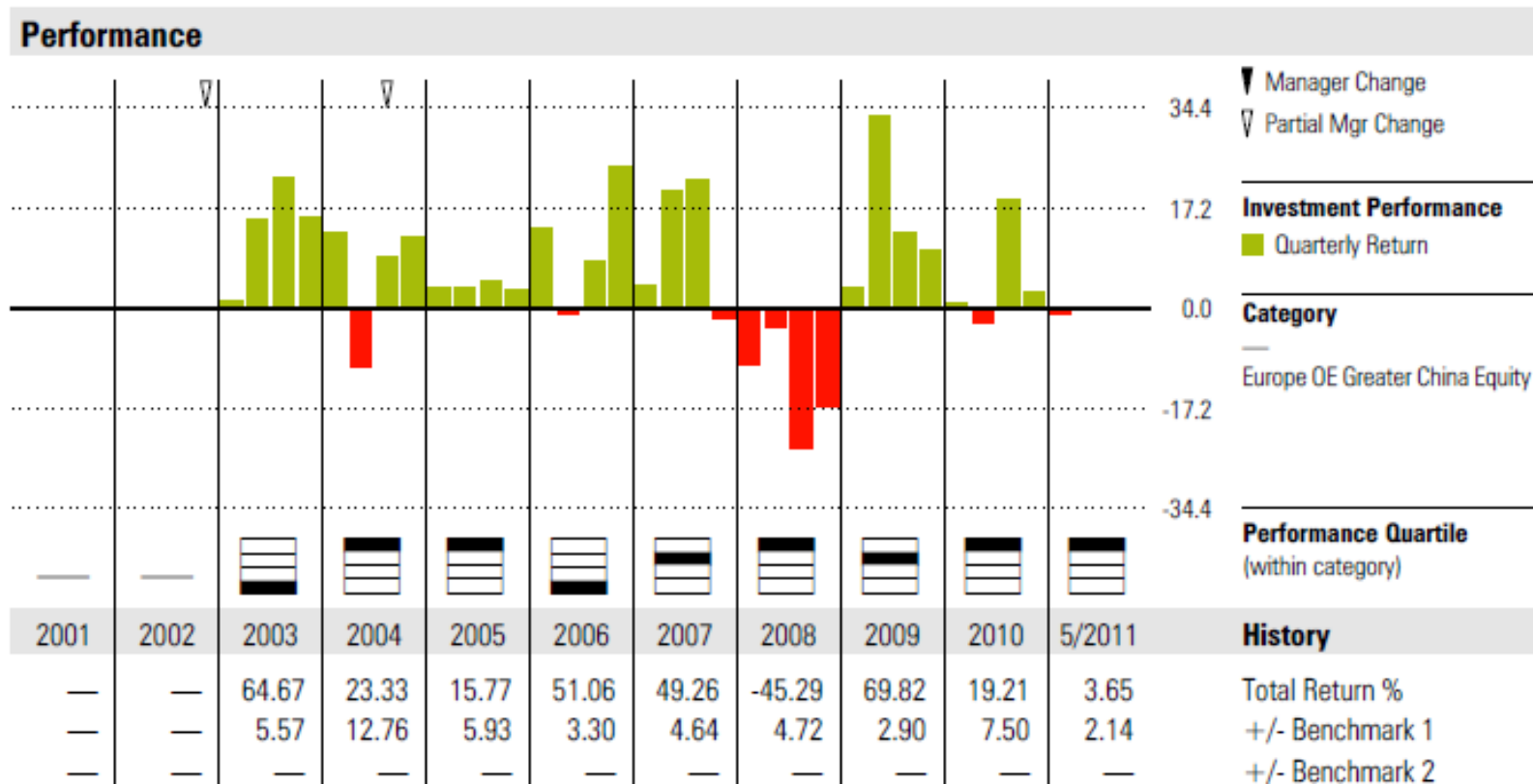
# Return Analysis: Return Patterns

▶ Case 2

<b>Relative Performance</b> 6/1/2006 to 5/31/2011		
	Bmark 1	Bmark 2
Excess Return	3.08	—
Alpha	2.92	—
Beta	1.01	—
R-Squared	97.94	—
Tracking Error	5.52	—
Information Ratio	0.56	—
Treynor Ratio	14.68	—
.....		
Up Capture Ratio	100.53	—
Down Capture Ratio	94.36	—
Up Number Ratio	0.91	—
Down Number Ratio	0.84	—
Up Percentage Ratio	0.54	—
Down Percentage Ratio	0.72	—

# Performance Analysis: Return Patterns

## ► Case 3



# Performance Analysis: Return Patterns

## ▶ Case 3

### Relative Performance 6/1/2006 to 5/31/2011

	Bmark 1	Bmark 2
Excess Return	5.86	—
Alpha	6.03	—
Beta	0.89	—
R-Squared	95.19	—
Tracking Error	6.05	—
Information Ratio	0.97	—
Treynor Ratio	17.72	—
.....		
Up Capture Ratio	97.63	—
Down Capture Ratio	79.75	—
Up Number Ratio	0.97	—
Down Number Ratio	0.78	—
Up Percentage Ratio	0.51	—
Down Percentage Ratio	0.70	—

# Risk Analysis: Backward Measures

*How should investors measure risks?*

- ▶ Standard Deviation
- ▶ Morningstar Risk

# Risk Analysis: Backward Measures

## **CASE STUDY**



# Risk Analysis: Backward Measures

## ▶ Case Study

- ▶ Fund: Asia Pacific ex-Japan Equity Fund
- ▶ Benchmark 1: MSCI AC Asia Pacific ex-Japan
- ▶ Benchmark 2: Category Average

Name	Morningstar Risk (5 Yr)
Fund	5.13
Category	7.34

## Return/Risk Analysis 6/1/2006 to 5/31/2011

	Inv	Bmark 1	Bmark 2
Cumulative Return	109.56	70.89	61.97
Standard Deviation	21.05	26.39	25.58
Sharpe Ratio	0.67	0.36	0.32
Sortino Ratio	1.02	0.52	0.46
Calmar Ratio	0.33	0.18	0.17
.....			
Best Month	13.52	15.24	15.80
Worst Month	-20.41	-24.47	-23.76
Best Quarter	26.62	33.07	33.22
Worst Quarter	-18.30	-24.03	-24.53
% of Up Month	66.67	58.33	61.67
% of Down Month	33.33	41.67	38.33
Avg Monthly Gain	4.63	5.93	5.39
Avg Monthly Loss	-5.21	-5.75	-6.16
Gain Std Dev	12.41	14.97	14.56
Loss Std Dev	15.89	20.41	19.82
.....			
Longest Up Streak (Mo)	8	6	13
Run Up %	28.26	24.37	53.09
Start Date	6/2006	2/2007	7/2006
End Date	1/2007	7/2007	7/2007
.....			
Longest Down Streak (Mo)	7	7	7
Run Down %	-41.16	-52.70	-51.86
Start Date	5/2008	5/2008	5/2008
End Date	11/2008	11/2008	11/2008
.....			
Max Drawdown (Mo)	16	16	16
Max Drawdown (%)	-47.70	-62.09	-61.25
Peak Date	11/2007	11/2007	11/2007
Valley Date	2/2009	2/2009	2/2009



# Risk Analysis: Backward Measures

## ▶ Case Study (con't)

- ▶ The fund operates at a TER of 1.57%

Category	Top of lowest 20%	Bottom of most expensive 20%	Overall Median Expense Ratio	# of share classes
Asia/Pacific ex-Japan Equity	0.91	2.14	1.67	538

# Risk Analysis: Portfolio Analysis

*How should investors evaluate risks on a forward-looking basis?*

- ▶ Portfolio Concentration
- ▶ Sector Concentration
- ▶ Country/Region Concentration

# News Analysis

*How should investors react to different kind of fund news?*

- ▶ Manager/Team Change
- ▶ Merger
- ▶ New Fund Launch

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