

16 Top Core Funds

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You may not have noticed, but the S&P 500 has averaged less than 2% so far this decade-- a reminder that a portfolio that just matches the market has not been good enough if you're trying to fund a child's education or retirement someday.

You wouldn't put most of your money into a savings account with that sort of return. Yet many of us do about the same with the core of our portfolio -- the largest portion.

Indeed, many think the core is too important to risk losing, so they protect it by keeping it in "risk-free" investments such as money market accounts that barely keep up with inflation. This is a great strategy if your primary goal is not to lose money. But if your portfolio is not already big enough to meet your financial goals, investing in risk-free securities pretty much guarantees that it never will be.

So if you want your portfolio to grow, it usually means investing in stocks. If you're a member of Marketocracy, you probably know that.

One pretty common approach to investing in stocks is through a fund that mimics a market benchmark such as the S&P 500. Advocates of this approach say that the S&P 500 index has averaged about 11% a year over the past 70 years, so they feel comfortable using it for planning purposes. But after the first nearly 7 years of this decade, those who invested the core of their portfolio in an S&P 500 index fund are now far behind plan.

It's time to consider alternatives for your core.

The acid test of whether a mutual fund should be considered for the core of your portfolio is whether the fund's current manager has a track record of beating the S&P 500 index after all fees.

Let's be clear that we are talking about the manager's track record, not the fund's. When you invest in a mutual fund, the single most important factor in determining your returns is the skill of the current manager. If the current manager took the helm 2 years ago, then only the last 2 years of

Get More From Your Core

as of 11/29/07

| Fund Name | Symbol | Morningstar Rating | Morningstar Category | YTD Return (%) | 1-Year Return (%) | 3-Year Return (%) | 5-Year Return (%) |
|---|--------|--------------------|----------------------|----------------|-------------------|-------------------|-------------------|
| <input type="checkbox"/> Wells Fargo Advantage Small Ca | SSMVX | ★★★★★ | Small Blend | 8.00 | 9.40 | 12.52 | 20.02 |
| <input type="checkbox"/> Amana Trust Income | AMANX | ★★★★★ | Large Value | 13.78 | 15.31 | 16.16 | 18.92 |
| <input type="checkbox"/> Allianz NFJ Small Cap Value In | PSVIX | ★★★★★ | Small Value | 6.70 | 8.47 | 12.63 | 17.66 |
| <input type="checkbox"/> Fidelity Contrafund | FCNTX | ★★★★★ | Large Growth | 18.75 | 20.05 | 16.35 | 17.61 |
| <input type="checkbox"/> Hancock Horizon Value Tr | HHGTX | ★★★★★ | Large Value | 7.26 | 9.64 | 12.99 | 17.19 |
| <input type="checkbox"/> DF Dent Premier Growth | DFDPX | ★★★★★ | Mid-Cap Growth | 16.09 | 16.77 | 13.67 | 16.53 |
| <input type="checkbox"/> JPMorgan Mid Cap Value Instl | FLMVX | ★★★ | Mid-Cap Value | 3.52 | 5.91 | 10.87 | 15.52 |
| <input type="checkbox"/> GAMCO Westwood Mighty Mites AA | WEMMX | ★★★★★ | Small Value | 7.65 | 13.26 | 13.60 | 15.28 |
| <input type="checkbox"/> GAMCO Westwood Equity AAA | WESWX | ★★★★★ | Large Value | 10.85 | 13.45 | 14.50 | 14.74 |
| <input type="checkbox"/> Gabelli Equity Income AAA | GABEX | ★★★★★ | Large Value | 8.86 | 12.10 | 12.15 | 14.46 |
| <input type="checkbox"/> Marketocracy Masters 100 | MOFQX | ★★★ | Small Blend | 2.81 | 9.16 | 10.67 | 14.12 |
| <input type="checkbox"/> American Century Strat Alloc: | TWSAX | ★★★★★ | Large Blend | 13.76 | 16.77 | 12.89 | 13.93 |
| <input type="checkbox"/> ICON Equity Income I | IOEIX | ★★ | Mid-Cap Value | 8.90 | 12.06 | 8.57 | 13.07 |
| <input type="checkbox"/> California Investment Equity I | EQTIX | ★★★ | Large Value | 2.59 | 4.92 | 8.84 | 12.90 |
| <input type="checkbox"/> Old Mutual Analytic Defensive | ANDEX | ★★★★★ | Large Blend | -1.58 | 1.20 | 8.37 | 10.56 |
| <input type="checkbox"/> ICON Income Opportunity I | IOCIX | ★ | Large Blend | 8.48 | 10.56 | 6.19 | 9.58 |

the mutual fund's track record is relevant. Whoever was managing the fund before that, is long gone and will have no impact on your returns.

People disagree about how long a track record is needed to assess a manager. But few would argue that you could do it with less than 5-years.

According to Morningstar, out of 10,929 domestic equity mutual funds, only 3,447 managers have been at the helm for at least 5 years. In other words, almost 70% of mutual funds should not be considered for your core portfolio because the current manager has simply not been there long enough to prove their skill.

Of the 3,447 funds where the manager has been at the helm for the last 5 years, 2,422 (about 70%) beat the S&P 500 over that period! This is somewhat surprising because I frequently read that the S&P 500 index beats 60 to 70% of all mutual funds. Turns out most of the funds that the S&P 500 beat over the last 5 years are those with relatively new and unproven managers.

Many of the 2,422 funds that beat the S&P 500 are just different share classes of the same portfolio. Limiting the set to "Distinct Portfolios Only" gets us down to 889 funds.

For the core of a portfolio, we don't want a single-sector fund or one that makes big bets. These kinds of funds require you to closely monitor them to decide when to invest and when to get out of their specialty area. As a result, they may be appropriate for the explore portion of your portfolio, but not for the core. Eliminating specialty funds and funds that put more than 30% of their portfolio in their top 10 holdings gets us down to 461 funds.

Since the core is the majority of most people's portfolio, the ability to protect capital in a bear market is an extremely important quality to find in a manager. Screening the remaining 461 funds for those that Morningstar ranked in the top 25% in bear markets narrows the field to 23 funds.

Finally, since you are doing your own research, you shouldn't have to pay a load. Of the 23 remaining funds, 16 are no-load.

The managers of all these funds have a 5-year track record of beating the S&P 500 (after all fees) with a diversified portfolio without making big bets while protecting the downside in bear markets. I think that makes them worthy of consideration as a core holding. I am proud to say that the mutual fund I manage is among them!

For information about Marketocracy's Funds
<http://www.masters100fund.com>

Nothing Works All The Time

The sectors and styles that did well for the past 5 years are unlikely to do as well in the future. Why? Because opportunities to outperform the market come to fruition when the market finds them and bids their prices up, thereby delivering above-market returns to early investors, while also reducing the opportunity to outperform in the future.

Opportunities to outperform the market are not permanent – at least you hope not, otherwise your excess returns would never materialize.

Always Field The Best Team

The key to outperforming the market over the long-term is to change your team as sectors and styles come in and out of favor.

The m100 are the most skilled stock pickers we have for the areas of the market that are performing well. What makes Marketocracy different from other firms is that we constantly re-evaluate our team, keeping the top performers, and benching those whose investment styles are out of favor so that we always field the best possible team.