On-line screening of mutual funds and ETFs -- Minimum Requirements

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*Summary: In this article, The Skilled Investor discusses minimum requirements for on-line mutual fund and ETF screening tools. This article summarizes our seven scientifically based fund selection criteria and reports on our survey of the capabilities of free on-line website tools to do screens using these criteria.*Automated fund screening tools should not make any arbitrary decisions for you about which funds you will use to pursue your investment objectives. An automated screening tool should simply winnow down a larger field of contenders to a smaller and more manageable list. It should screen funds for you only in the manner that you want it to screen funds. You should not compromise your screening process by using tools that do not allow you to do what you want to do. Once you have your smaller, screened list of funds, you can investigate remaining funds in greater depth. Once you are satisfied with one or several funds that meet your investment criteria, then you can invest directly by downloading, completing, and mailing in investment account forms with your check. Alternatively, you can call a fund's 800 number, if you need a little help to set up your account and make your investment. (IRA accounts are more complex than regular taxable investment accounts, so making a call to a fund's IRA department can be a very good idea to make certain you have the right forms and have completed them properly.) The only cost to you of buying mutual funds directly is your personal time and effort. However, the savings value can be huge over your lifetime, if you buy funds directly and cut out costly sales agents in the middle.

Note: If you want to understand how much you personally could waste by paying excessive investment costs over your lifetime, see this article about VeriPlan. Across your lifecycle, VeriPlan automatically projects the full value of the personal assets you could lose to the five main types of investment costs. VeriPlan develops projections that assume you will continue to invest at the same level of cost-efficiency or cost-inefficiency associated with your current financial asset portfolio. Alternatively, VeriPlan's automated Cost-Effectiveness Tool lets you compare investment costs that you believe are more reasonable to pay versus the investment costs of your current portfolio.

Functional requirements for automated mutual fund screening tools are necessarily more stringent than for ETFs. This has nothing to do with any preference for one type of fund over the other. While there are some notable differences between mutual funds and ETFs that can be important to some investors, mutual funds and ETFs are much more alike as investment vehicles than they are different. The reason for more stringent screening of mutual funds is simply because there are thousands of mutual funds that must be screened out, before you can get down to a smaller, more manageable list for more thorough evaluation. U.S. mutual funds have been around for many decades, appearing first in the 1920s. The Investment Company Institute's monthly "Trends in Mutual Fund Investing" reported that at the end of 2006, there were: 4,765 equity funds, 1,996 bond funds, 508 hybrid funds (equity+bond), and 848 money market mutual funds for a total of 8,117 mutual funds.1 These are mutual funds offered by U.S. investment fund companies that invest in domestic and/or international securities. In contrast, ETFs are a relatively recent financial innovation and have only been in existence since the early 1990s. While assets invested in ETFs are growing at rapid rates, total ETF assets are small compared to the approximately $10.4 trillion dollars in U.S.

mutual fund assets.2 The number of different ETFs is proliferating at an increasing rate, but there still are only a couple of hundred ETFs to select among. While an automated ETF screening mechanism is still required, screening ETFs is much less challenging compared to choosing among the many thousands of mutual funds.These are *The Skilled Investor's* minimum requirements for an on-line mutual fund or ETF screening tool. A screening tool should:->have automated access to a complete, accurate, recent, and unbiased data set offering information about the universe of available funds that could be contenders for your money, ->offer flexible screening mechanisms that allow you to slice and dice the data the way that you want to screen funds, and ->not have any inherent bias in the way the screening mechanisms work. A screening tool should only eliminate from consideration those funds that you would not want to consider, and it should not retain funds in your list that have characteristics that are not desirable to you. In essence, a screening tool should not make mistakes either way by screening out funds you might want to consider or by screening in funds that you do not want.Free is better. If a free screening tool with complete data and a sufficiently functional screening mechanism can be found on the web, why pay? If not, it might be necessary to pay a subscription fee to obtain access to better data and functionality. Of course, with a free screening service, we should not really expect an entirely free lunch, because "free" on the Internet is never ad free.While there would seem to be many dozens of websites offering free and/or paid fund mutual fund screeners, in fact, the task of finding one or two to use is not as difficult as it might first appear. Looking first at the source of the data, you will find that there are only a small number of mutual fund data suppliers. While there are other data suppliers, such as Value Line and Standard and Poors, the two leading mutual fund data suppliers are Morningstar, Inc. and Lipper, Inc. When you encounter an on-line fund screener, if it includes the Morningstar one-to-five-star rating system or the Lipper one-to-five Lipper score rating, this tells you where the data came from, if the site does not tell you explicitly. Both Morningstar and Lipper have developed substantial businesses selling their data services to professional financial advisors, to a wide variety of investment organizations, and to numerous websites. By far, Morningstar has made the most successful effort to attract individual investors as customers for free web-based information and for paid subscription services on their own website. Concerning available screening tools on the web, the utility of a tool depends primarily on how you want to slice and dice the mutual fund data. Many sites could satisfy your screening requirements, if they allow you to cut the data the way you want it. However, for purposes of this screener evaluation, we already have a set of seven scientifically based screening criteria. Our seven criteria make it challenging to find one or more (hopefully free) mutual fund screeners on the web that can do the job. Summarized in this article published previously on The Skilled Investor Blog, Scientific mutual fund and ETF screening criteria: a summary, these seven screening criteria are: 1) minimum management expenses, 2) minimum turnover, 3) zero sales charges, loads and marketing fees, 4) avoidance of very large funds with higher trading costs, 5) avoidance of immature funds, 6) a minimally sufficient asset base over which to spread required fund expenses, and 7) the exclusion only of funds with very poor historical performance records. After surveying several dozen free screeners on major brand name sites, *The Skilled Investor* found certain common themes. Many, if not most, free on-line fund screeners tend to:->focus on screening in the minority of funds with superior historical performance rather than screening out the bottom of the barrel, ->provide inadequate means to screen for very low investment management expenses. (For example, only being able to screen for funds with expense ratios of "1% or lower" is just not very useful.) ->do not provide a clear means to eliminate funds with sales charges, loads, and marketing fees, ->ignore fund turnover altogether, ->do not provide a "Goldilocks" fund size screening capability to allow you to eliminate funds that are too big and too small and leave those in the middle that are just right in terms of total assets, ->do not provide an easy mechanism to eliminate very young funds, and ->promote certain fund families - if not directly in the screening mechanism, then in prominent adjacent advertisements. In general, most on-line fund screeners available on major brand name financial websites are very weak. Presumably, for most of these sites the underlying fund database supplied is from a major data vendor and is complete and up-to-date. Nevertheless, the screening functionality offered is crude and focuses largely on abetting investors who chase after superior historical performance and sorting funds by investment sectors. Superior historical performance is irrelevant, but no site can ignore it. Investment sectors can be important for certain aspects of constructing your personal portfolio, but that discussion is beyond the scope of this article.After checking the screening capabilities available on several dozen brand name financial sites, Morningstar.com and IndexUniverse.com were identified as two free sites with screeners that are adequate to implement our seven scientific fund selection criteria. Morningstar.com offers the strongest mutual fund screening features and covers the universe of mutual funds. Morningstar.com also offers a simple, free ETF screener that is adequate for screening. IndexUniverse.com provides a highly functional and free on-line screener that allows you to screen both index funds and ETFs on a wide variety of variables.

[Note that there is no business arrangement of any kind between *The Skilled Investor* and Morningstar.com or IndexUniverse.com. These websites simply meet the requirements laid out in this article.] Since we have found at least one free screener that could do the job, then paying a subscription to any website to obtain more advanced functionality is unnecessary. Many sites offer very minimalist free screening functionality and some offer greater screening functionality, if you are willing to enter into a paid subscription fee arrangement. Because we found free screeners that could do the job, we did not investigate the quality of any of these paid screeners.We did not attempt a comprehensive survey of all websites with screeners. If you know of any other free site that you think offers the necessary capabilities discussed in this article, please leave a comment below, and we will take a look. Specific examples of how to use the Morningstar.com and IndexUniverse.com fund screeners to implement our seven scientific fund screening criteria will be the subject of future articles on *The Skilled Investor*. Use the search functionality to the left to find them, if you are reading this after the publication of those articles.1)

http://www.ici.org/stats/latest/trends_12_06.html (February 1, 2007)2) ibid