

## **The Mechanics of the Fund Authority Score System for Stock ETFs and Mutual Funds - Part 3**

**Category : The Fund Authority Score System for Evaluating Mutual Funds and ETFs**  
**Published by [The Skilled Investor](#) on Nov/18/2007**

Fund Authority Scores for Stock ETFs and Mutual Funds - Fund maturity and operating efficiency  
Fund Authority Scores rate mutual funds and ETFs on the most important economic factors affecting long term diversified stock or equity investment fund performance. This article explains the investment fund maturity and operating efficiency factors.

[Parts 1 and 2 of this article discussed the first three, most heavily weighted factors used in the -10 points to +10 points Fund Authority Score rating system. These first three factors are:](#)

[FACTOR 1: Annualized Investment Management Expenses and Sales Load Fees \(-4 to +4 points\)](#)

[FACTOR 2: Hidden Trading Costs using Fund Portfolio Turnover as a Proxy \(-3 to +3 points\)](#)

[FACTOR 3: Penalize very inferior historical performance and credit average and superior historical performance \(-2 to +2 points\)](#)[You can find a directory of Fund Authority Scores for mutual funds and ETFs here.](#)

FACTOR 4: Is the investment fund sufficiently mature? (0 or 1 point)Diversified investment fund companies habitually create new funds. Breeding new funds allows fund companies to promote new funds that may get lucky and demonstrate above average returns over a very short period. Like moths to a flame, many individual investors will flock to any fund with seemingly superior results - no matter how short-lived or small the fund might be. Performance charts attracts the investment assets of naive performance chasing individual investors and stock brokers and investment advisors who egg them on. (See this article: [How to lie with statistics: Investment performance charts](#))More lousy stock mutual funds and ETFs are born than are accidentally 'superior' funds, and fund promoters simply commit infanticide with their laggard funds. Unfortunately, in addition to having already delivered inferior performance, laggard funds tend to get merged into a fund family's larger more mature funds that also have lousy performance records. (See this article: [Choose sufficiently mature mutual funds and ETFs](#))With hundreds of much better ETFs and mutual funds with longer track records, you simply do not need to play this fund industry birth and death game with your hard earned money. Since you are more likely to lose than win with very young funds, the Fund Authority Score includes a credit of +1 point, when a fund has been in existence at least 3 years. SCORING FOR THE FUND MATURITY FACTOR #4

Funds in existence less than 3 years = 0 points

Funds in existence 3 years or more = +1 pointFACTOR 5: Operating inefficiency penalty for very small funds (-1 or 0 points)To amortize the management expenses that are necessary to manage properly a diversified investment fund each year, some minimum total asset figure is required. To illustrate, a \$100M equity mutual fund with a 1% expense ratio yields \$1 million annually for management expenses. In the grand scheme of what it takes to run each year, \$1M is just not a lot of money - particularly for an actively managed fund. Therefore, it is reasonable for you to set minimum asset size selection criteria. (See this article: [Choose mutual funds and ETFs with a minimum economical portfolio size](#))SCORING FOR THE OPERATING INEFFICIENCY PENALTY FOR VERY SMALL FUNDS FACTOR #5

Funds with less than \$250 million in portfolio assets = -1

Funds with more than \$250 million in portfolio assets = 0Summary of the Fund Authority Score rating system for stock or equity mutual funds and ETFsFACTOR 1: Annualized Investment Management Expenses and Sales Load Fees (-5 to +5 points)

FACTOR 2: Hidden Trading Costs using Fund Portfolio Turnover as a Proxy (-3 to +3 points)

FACTOR 3: Penalize very inferior historical performance and credit average and superior historical performance (-1 to +1 point)

FACTOR 4: Is the investment fund sufficiently mature? (0 or 1 point)

FACTOR 5: Operating inefficiency penalty for very small funds (-1 or 0 points) COMBINATION OF FACTORS 1 TO 5 for the Fund Authority Score system (-10 to +10 points)

---

[These related articles may also be useful to you: Selecting Investment Funds: ->Rational selection of bond and equity mutual funds and ETFs -- overview ->Avoid mutual funds and ETFs with sales commissions and 12b-1 fees ->Avoid mutual funds and ETFs with higher investment portfolio turnover ->Avoid very large actively managed mutual funds and ETFs ->Evaluate historical investment performance, but only after using other investment screening criteria Controlling Investment Costs:](#)

[->Excessive investment costs are a huge problem for individual investors ->How much do hidden mutual fund trading expenses cost you? ->Beware of large and hidden mutual fund costs ->Invest in fixed income securities through bond mutual funds with low investment fees ->Is it worth paying higher bond mutual fund management fees? ->Passive individual investors are &ldquo;free riders&rdquo; who benefit from the higher costs of active traders ->The investment industry is not your investment partner](#)