

the new Morningstar Ratings could have some predictive value regarding performance. (See: [Do the "new" Morningstar star Ratings predict superior fund performance?](#)) Sometimes

Morningstar's commentary on the star rating system gives rise to ambiguities. For example, Morningstar's 2002 Fact Sheet on the revised star rating system said: "Because the funds in a given category are similar in their risk factor exposures, the observed return differences among them relate primarily to security selection ("stock picking") or to variation in the timing and amount of exposure to the risk factors that collectively define the category ("asset weighting"). Each of these, over time, may be presumed to have been a skill-related effect." Because this Morningstar statement argues that past performance is presumably due to fund management prowess in stock picking and/or market timing, one then needs to believe that such measured skill actually exists and that it explains past differences in management performance. However, Morningstar's lack of confidence in the predictive abilities of its stars regarding performance would seem to imply that some other unspecified factor must cause an interruption in the continuity of this skilled performance record of accomplishment. This unspecified factor must be operating quite frequently, because Morningstar Ratings have been highly unstable over time (See: [How stable have Morningstar Ratings for mutual funds been over time?](#) and [What the instability of mutual fund Morningstar Ratings means for long-term investors ‐ Commentary](#)) We are left with the classic quandary about active investment management. How much is skill and how much is luck? The scientific finance literature on this topic indicates very little evidence of superior, skill-based performance persistence for active management. Moreover, if it exists, its value to investors tends to be greatly outstripped by the high fees charged by active managers. The only compelling evidence about mutual fund return or performance persistence is that very poor performance in the past is more likely to continue into the future. (See: [Do Morningstar Ratings predict risk-adjusted equity mutual fund performance?](#)) Finally, note that Morningstar's position on the efficacy of its star ratings from a performance prediction standpoint contrasts with the actions of many mutual fund investors who apparently believe that the star rating system has predictive powers concerning risk-adjusted returns. (See: [Does it pay to trade when the Morningstar Rating of a mutual fund changes?](#)) Also, see these related articles:

->[Investment astrology ‐ should you pick investments according to the Morningstars?](#)
->[Morningstar Ratings should be used with caution](#) ->[How the new Morningstar Ratings for mutual funds have been determined since mid-2002](#) ->[The quality of the "old" Morningstar Ratings prior to mid-2002](#) ->[Simplifying investment decision making can be taken too far](#) ->[High Morningstar Ratings can lure you into funds with costly sales loads](#) ->[How Morningstar Ratings for mutual funds are used as a marketing tool](#) ->[Do mutual fund Morningstar Ratings changes influence individual investors?](#) ->[What might be wrong with buying a mutual fund with a 4 or 5 star Morningstar Rating?](#) * The Morningstar Rating is a trademark of Morningstar, Inc. The Morningstar Rating has also been referred to in the media as the Morningstar stars, the star rating, the star rating system, etc.

1) <http://www.morningstar.com> and <http://datalab.morningstar.com> (Note that morningstar.com is a website for individual investors, and datalab.morningstar.com is a website for institutional and advisor clients.)

2) Morningstar, Inc. "Fact Sheet: The New Morningstar Rating(tm) for Funds." 2002 http://corporate.morningstar.com/US/documents/MethodologyDocuments/FactSheets/MorningstarRatingForFunds_FactSheet.pdf

3) Morningstar Press Release: "Morningstar, Inc. to Change "Star Rating" for Funds ‐ Moving to Category-Based Rating, Enhancing Risk-Adjusted Return Measure." April 22, 2002. <http://www.morningstar.com/press/release/item/0,1045,648,00.html>

4) Benz, Christine. "Special Report: Introducing Morningstar's New Star Rating." July 03, 2002. <http://news.morningstar.com/article/article.asp?id=77455& QSBPA=Y>

(Note that Morningstar Analyst Reports are another Morningstar proprietary service available to subscribers as part of its Premium Membership.)

5) Schiffres, Manuel and Steven T. Goldberg. "The World According to Morningstar." Kiplinger's Personal Finance Magazine. February 1997, Volume 51, Issue 2

6) "The New Morningstar Rating Methodology." Morningstar Research Report, 22 April 2002. page 7 http://datalab.morningstar.com/Midas/PDFs/Research_StarRating.pdf