

INVESTING



Mutual Funds' Secret Weapon

[By Amanda B. Kish, CFA]

Every mutual fund investor wants to own great funds that outperform the market year after year. But finding these funds can be tricky. Past performance can't guarantee future returns, and even the best managers hit occasional rough spots. How can Foolish investors tell which funds are more likely to rise to the top of the heap?

The key to strong performance

A recent *Wall Street Journal* article may have an answer. According to new research from Standard & Poor's, funds that consistently outperform others in their peer group typically have long-tenured managers at the helm.

Within a universe of large-cap stock funds, Standard & Poor's study showed that the average portfolio manager stuck around for 5.6 years. But large-cap funds that consistently ranked in the top half of the fund universe had an average manager tenure of 9.5 years.

In a separate study, S&P found that manager tenure was one of the key factors in distinguishing funds that beat both their peers and the index. In fact, longer manager tenure was more strongly linked to higher performance than were low expenses or widely diversified fund holdings.

Thinking long-term

These findings shouldn't surprise you. A veteran manager with a solid history of following the fund's mandate is much more likely to succeed than a rookie. While some superstar managers may garner assets and media coverage by posting a year or two of stellar performance, these stars can flame out over the long run - the time frame on which Fools should focus most.

Of course, many fund companies figured out long ago that management turnover makes investors nervous. To avoid this problem, many funds work under a team structure, rather than designating one or two portfolio managers.

One of the most prominent examples of this approach is Capital Research & Management, the advisor for American Funds. CR&M uses multiple "portfolio counselors" for each American Fund, leaving no fund too reliant on any one individual, and curbing the effect of managers' departures on fund operations. This approach has worked well for CR&M, judging from the long-term success of its two largest funds. The **Growth Fund of America** (AGTHX) invests in domestic large-cap stocks such as **Google** (Nasdaq: GOOG) and **Target** (NYSE: TGT), while the **Europacific Growth Fund** (AEPGX) focuses on foreign companies such as **Bayer** (NYSE: BAY) and **Toyota** (NYSE: TM).

Examining manager tenure

When seeking worthwhile mutual funds, make sure to check the current management's tenure. Ideally, you want managers who've been with a fund for at least seven years, giving them experience managing assets in both positive and negative market environments. If you must choose between seasoned management and currently chart-topping performance, play it safe. Odds are that the longer-tenured manager will produce solid returns over the long term, whereas the current hotshot may not.

What if a fund you own announces its current manager's departure? Study his or her replacement carefully. An experienced substitute is fine, but if your holdings will be headed by a newcomer with no previous experience at your fund, consider selling. Even if the new manager has a history with your fund, either as a co-manager or an analyst, check their tenure in that post. A co-

manager with only a year or two's experience wouldn't reassure me enough to continue holding the fund.

Manager tenure is one of a fund's most important attributes, yet it's often overlooked by investors rushing to buy funds with the highest short-term returns. Simply put, funds with long-term management structures outperform their peers, and a change in management is one of the biggest reasons to consider selling a fund. Keep these points in mind when investing, and your odds of finding a truly winning fund will greatly improve.

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