

Patron Training: Morningstar Fund Reports



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Morningstar's Approach to Mutual Funds

Morningstar has been analyzing mutual funds for more than 20 years. Whatever the security type or asset class, Morningstar takes a fundamental approach to investing. That means the company analyzes mutual funds down to the individual securities that the fund owns. Morningstar believes investors should educate themselves about their investments and seeks to provide the data, analysis, and tools that allow investors to do so.

When it comes to analyzing mutual funds, Morningstar thinks there are five critical questions investors must ask and be able to answer about any fund that they own or are thinking about owning:

1. What does the fund own?
2. How has the fund performed?
3. What are the fund's risks?
4. Who runs the fund?
5. What does it cost?

Each fund report that you'll find in Morningstar.com Library Edition provides the answers to these questions.

Accessing Mutual Fund Reports

Direction: Speaker will review with patrons how to access Morningstar.com Library Edition via the library's Web site.

Once in Morningstar.com Library Edition, you can access reports two ways:

1. The Reports tab
2. Typing the name or ticker into the report box on the home page

For our session today, let's use Fidelity Magellan (ticker: FMAGX) as our example.

Direction: Type FMAGX into the reports box on the home page; click Go

This is the largest mutual fund in the industry, which means it has the most assets and the most shareholders, and is included in many retirement plans. It's therefore very popular and often searched for—and is perhaps even a fund that some of you own.

From an individual fund report, you can always access a different fund report by typing the name or ticker of that fund in the ticker box that appears atop the report page. You don't have to return to the home page to access another report.

Navigating a Report

Understanding how to navigate a fund report is critical, because it's the best way to take full advantage of Morningstar's research and data.

The left-hand navigation bar leads you to the main pages of the report. So, for example, we can access the

Analyst Research page by clicking on that tab.

Direction: Click on Analyst Research tab in left-hand navigation bar.

Once you're within a page of a fund report, secondary navigation tabs often appear atop the page that lead you to different sections of main pages. As an example, you can see on the Analyst Research page there appears a secondary section: Analyst Report Archive. We'll review the details of this area later in our session.

Let's go back to the Snapshot page.

Direction: Click on Snapshot tab in left-hand navigation bar.

Throughout the pages of the fund report, you'll also find a scattering of underlined terms or question marks. Click on one of these and you'll be taken to defined terms. And at the bottom of every page, you'll find a Show Data Definitions link. When you click on it, you'll find definitions to every term that appears on this page.

Today we won't be able to review every single page in a Fund Report so I'm going to focus on the pages that are of most interest to most investors.

Snapshot

The first page of the fund report that I'd like to review is the Snapshot page. This is the first page you'll see when you request a fund report. Think of the Snapshot page as a mutual fund's home page. The Snapshot provides a quick glimpse of some essential information. Here you can find quick answers to several of the five questions that I mentioned earlier.

The basic information on this page includes performance statistics, star ratings, the fund's category, and some portfolio data.

Subsequent pages of the fund report provide more detail on most of the data that you see on the Snapshot page.

Data Interpreter

Our library's users—and perhaps this audience today—include investors with a wide range of investment experience. Some of you may have been investing for years while others may not yet have invested your first dollar. Morningstar's fund reports are built to appeal to investors of all levels of investment expertise.

Direction: Click on the Data Interpreter tab in the left-hand navigation bar.

In particular, the Data Interpreter page of a Morningstar fund report was built for those patrons who aren't familiar with investment terms and information. Data Interpreter puts that data in context—you don't have to figure out what the raw data means because Data Interpreter explains it for you.

Morningstar includes a Data Interpreter page for the nearly 17,000 funds included in Morningstar.com Library Edition.

Analyst Research

In addition to the interpretive text that appears in Data Interpreter, Morningstar provides in-depth analysis for 2,000 of the largest and most popular funds. The analysis explains whether a fund is a good investment and if so, for whom. Patrons access this analysis via the Analyst Research tab.

Direction: Click on the Analyst Research tab in the left-hand navigation bar.

The Analyst Research area of a fund report is a favorite among Morningstar.com Library Edition users. In fact, users often want to know more about Morningstar's analyses. Here are answers to a few common questions:

Q: How large is Morningstar's fund analyst staff?

A: Morningstar maintains a staff of about 25 mutual fund analysts. The analysts specialize in particular fund families and/or types of funds (fixed income, large company, international stock, etc.)

Q: How often are fund analyses updated?

A: As news warrants. The biggest funds are updated at least quarterly and every fund is updated at least twice per year.

Q: How do the fund analysts conduct their research?

A: The fund analysts conduct various types of research to build their case for or against a particular fund. For starters, they'll always try to interview the fund's manager to get an update about what's going on with the fund recently. They also analyze fund-related documents, including annual reports and prospectuses. Most importantly, however, they draw on their experience analyzing other funds in the same category.

I'd like to point to some of the secondary navigation under the Analyst Research tab that I referred to earlier—navigation that appears atop this page. It's the Analyst Report Archive. Morningstar provides a complete archive of all fund analyses written for a fund since 1993. This feature provides a robust history of a fund and Morningstar's opinion of that fund through the years.

Fiduciary Grades

One of Morningstar's most recent innovations, which the company launched in mid-2004, is the Stewardship Grade for funds.

Direction: Click on Stewardship Grades in the left-hand navigation bar.

Morningstar believes that this new feature is so important that the company has given the Stewardship Grades their own tab in the left-hand navigation bar. Morningstar launched the Stewardship Grades in response to public demand: Several scandals involving trading activities at big-name fund families rocked the fund industry in 2003 and 2004, and investors looked to Morningstar for a measure they can use to help them sidestep potential landmines in the future.

To learn how Morningstar analysts arrive at their conclusions, you can click on the Stewardship Grade Methodology link at the right-hand side of the fund's Stewardship Grade page, just above the summary. Doing so will spawn a PDF detailing the process by which analysts determine Stewardship Grades for funds.

Direction: Point to the Stewardship Grade Methodology link.

The Morningstar Stewardship Grade for funds is designed to help investors further research, identify, and compare fund managers and fund companies that do a good job—or a poor job—of aligning their interests with those of fund shareholders. These Grades go beyond the usual analysis of strategy, risk, and return. They help investors assess a fund based on:

1. The manner in which the fund is run.
2. The degree to which the management company's and the fund board's interests are aligned with those of fund shareholders.
3. The degree to which shareholders can expect their interests to be protected from potentially conflicting interests within the management company.

Morningstar analysts score five components of a fund: regulatory issues, board quality, manager incentives, fees, and corporate culture. The analysts gather information from public filings, responses that fund companies provide on a detailed questionnaire, and their own experiences with the fund and its family. Funds are then assigned a grade of A through F based on their scores for the five components.

The Morningstar Rating for Funds

Stewardship Grades are relatively new informational tools that Morningstar provides for investors. However, the tool that Morningstar is perhaps best known for is the Morningstar rating for funds. Given the popularity of the rating, Morningstar dedicates a page in the Fund Report to the rating and its parts.

How Morningstar calculates its ratings is a popular question. In a nutshell, the Morningstar Rating for funds is based on historical risk-adjusted performance. Morningstar rates funds according to how they performed historically versus similarly managed funds, adjusted for risk. A fund must have three years of performance to earn a Morningstar rating. Morningstar rates funds over three-, five-, and 10-year periods and then weights those periods to get an overall rating. And Morningstar depicts all of those periods—plus the risk—on this page of the Fund Report.

Perhaps most importantly for you, though, Morningstar provides a link to a methodology PDF. Here are the details about exactly how the rating is calculated.

Direction: Highlight the Methodology link on the Morningstar Rating page.

I'd now like to touch on a couple of other tabs that contain information showcasing Morningstar's fundamental approach to investing and that investors tend to gravitate toward.

Portfolio

Direction: Click on Portfolio in left-hand navigation bar.

A fund's portfolio matters to investors because the portfolio is what drives the fund's performance: The stocks and bonds that the fund owns motor the returns. A fund is nothing more than the securities it holds.

On the Portfolio page, Morningstar provides a detailed look at what a fund owns using tools that depict the size and type of companies that the fund owns and, on a separate tab, the fund's 25 largest holdings. And users who are especially interested in learning more about the securities that a fund owns can click on a stock's name in the Top 25 Holdings tab and view a Morningstar Stock Report on that investment!

Direction: Click on the top holding of Fidelity Magellan; you'll be taken to its Stock Report. Then, click the Back button to return to the Portfolio page.

Fees & Expenses

Investors always want to know what they're paying to invest in their mutual funds. Although you may never write out a check to a mutual fund for services rendered, you are in fact paying fees to have the fund invest in securities on your behalf.

Morningstar details all costs associated with a mutual fund on the Fees & Expenses page.

Direction: Click on Fees & Expenses in the left-hand navigation bar.

The Fees & Expenses page lists any sales charges and annual fees investors pay for the mutual fund. In addition, Morningstar puts fees in real-world terms, not just standard percentages, in the Cost Projection area. Investors can see, in dollars, what they can expect to pay over a variety of time periods.

Other Fund-Related Content on a Fund Report

Morningstar provides several other pages of data and analysis in their Fund Reports—too many for us to cover in-depth today.

Direction: Simply point to, but do not click on, the following tabs in the left-hand navigation bar.

- ▶ The Purchase Info page tells you how and where you can purchase this fund.
- ▶ The Management page provides information about who is running the fund and what experience this person has.
- ▶ The Risk Measures page provides a variety of different risk statistics for the fund, including the fund's beta and standard deviation.
- ▶ The Tax Analysis page details how good the fund has been at maximizing its aftertax returns. This information is especially important if you're investing in mutual funds in taxable accounts.
- ▶ The Total Returns page illustrates a fund's returns over a variety of time periods and compared with several benchmarks, including a relevant benchmark, and to other funds in the same investment category.
- ▶ The Formatted Report link allows you to download a print-friendly single-page PDF of the Fund Report. The Formatted Report includes much of the same information that appears in the Fund Report, including the analysis.