2014 Morningstar U.S. Mutual Fund Industry Stewardship Survey

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Contents

Executive Summary

Morningstar has long maintained that investors win when they partner with good stewards of capital, and this study supports that position. The research examines data that Morningstar created in 2011 to help evaluate asset managers' stewardship attributes among the mutual funds they manage, and it finds that firms with the highest levels of manager tenure, manager retention, and ownership of mutual fund shares also have delivered better outcomes for investors. The same is true of firms that offer funds with lower expense ratios.

Morningstar measures investor outcomes at the firm level through its success ratios, which express as a percentage the number of fund share classes that survive and outperform based on the funds' category rank and risk-adjusted category rank over the subsequent three, five, and 10 years. This study finds that firms with stronger firm-level data have higher Morningstar Success Ratios, on average.

Finally, this examination of Morningstar's firm-level data suggests that the data points are not highly correlated, which means that they independently help evaluate firms' stewardship practices, and one data point cannot easily be substituted for another to arrive at the same conclusion.

This firm-level data helps inform Morningstar's qualitative assessment of fund firms' stewardship practices. Morningstar's comprehensive evaluation of asset-management firms includes an examination of each company's Corporate Culture, Fund Board Quality, Fund Manager Incentives, Fees, and Regulatory History. Morningstar's view of asset managers is reflected in forward-looking Parent ratings of Positive, Neutral, and Negative, as well as Stewardship Grades. These holistic evaluations of about a fourth of U.S. fund firms also suggest that good stewards are better caretakers of capital as measured by the Morningstar Success Ratios.

Studying Stewardship

Trust is a critical element in any meaningful relationship. People entrusting their money to others to invest their savings and act as good stewards of their capital should expect no less, and in fact, their choice of partner may be one of the most important decisions they'll make. The required transparency and a strong regulatory environment in the United States mutual fund industry go a long way in helping to establish that trust. However, simply following the rules isn't enough. There are other stewardship practices that reveal the extent to which a firm puts investors' interests before those of portfolio managers or the broader asset-management company.

Morningstar's assessment of firm-level stewardship, which manifests itself in a Parent rating and/or a Stewardship Grade for the offering firms, goes well beyond an examination of a firm's regulatory history. A key factor is corporate culture, which Morningstar assesses primarily on a qualitative basis through regular on-site due-diligence visits and telephone interaction during which analysts interview senior managers and others in important functions. The strongest corporate cultures exhibit a clear mission to put fundholders first and are able to attract, retain, and nurture professionals who can execute that goal. Other important criteria include a firm's approach toward the fees it charges fundholders and whether portfolio managers' financial interests are aligned with those of fundholders. The quality and track record of mutual funds' boards of directors deserve examination, as well.

Morningstar has been closely measuring such stewardship practices, on both a qualitative and quantitative basis, for more than a decade and contends that good stewardship practices lead to better outcomes for investors. In fact, the 2011 Morningstar Mutual Fund Stewardship Grade Research Paper demonstrated that funds with higher Stewardship Grades produced higher-ranking investment returns. The 2011 stewardship study supported Morningstar's decision to include the assessment of a fund's parent-company stewardship in its Morningstar Analyst Ratings for funds and its evaluations of target-date series and 529 college-savings plans.

To support qualitative research on firms' stewardship, Morningstar created in mid-2011 firmwide data points that represent hallmarks of good stewardship. These data points key in on manager retention and tenure on mutual funds, manager co-ownership with fundholders, and fees. These data, computed on every company offering mutual funds, allow Morningstar and investors to measure stewardship practices across the industry, not only on the firms Morningstar rates qualitatively.

This research paper examines whether Morningstar's philosophy that good stewardship leads to good investor outcomes is supported by this industrywide data set. This philosophy is reflected in Morningstar's Parent ratings and Stewardship Grades, which are supported in part by the firmwide data points. To assess good investor outcomes, the paper looks at the Morningstar Success Ratio, which measures what percentage of a firm's funds have both survived a particular time period and outperformed the median fund in their respective categories. The Morningstar Risk-Adjusted Success Ratio measures what percentage of a firm's funds both survived the time period and delivered a Morningstar Risk-Adjusted Return better than the median fund's in their respective categories.

Using the success ratios not only captures performance but also avoids survivorship bias; firms are penalized for merging away or liquidating their poorest-performing funds or those that didn't gain enough traction with investors to remain viable. Although in some cases, these decisions may be the right ones, a firm that regularly sweeps weak performance records under the rug or habitually launches and then merges away unsuccessful funds may not always have investors' best interests at heart.

Stewardship Coverage Details

Morningstar began formally evaluating stewardship practices in 2004, in the wake of the mutual fund market-timing and late-trading scandals that plagued nearly two dozen companies. These firm-level transgressions proved costly to fundholders, and it was clear that those offending firms had put their own interests ahead of their fundholders' in their efforts to gain and retain assets (on which their revenues are based).

At that time Morningstar began studying stewardship practices and produced Stewardship Grades and Stewardship Reports on a select group of individual mutual funds and their parent companies. Over the years the methodology used to compute these grades has evolved somewhat, but it continues to hinge on five key areas: Corporate Culture, Fund Board Quality, Manager Incentives, Fees, and Regulatory History.

Today, Morningstar produces Stewardship Grades for asset-management firms and Stewardship Reports on the U.S. fund industry's 20 largest firms by assets, which together manage more than two thirds of open-end mutual fund assets.

Morningstar Analyst Ratings and Parent Pillars

Morningstar's stewardship efforts have expanded since the launch of the Morningstar Analyst Rating for funds in November 2011. These ratings are subjective, forward-looking assessments of an individual mutual fund's chances of long-term success on a risk-adjusted basis. Positive Morningstar Analyst Ratings come in the form of medals: Gold, Silver, and Bronze. Morningstar analysts also issue Neutral and Negative ratings. Altogether, Morningstar analysts assign Morningstar Analyst Ratings to more than 3,500 funds globally. Key to the Morningstar Analyst Ratings is the assessment of five components, or pillars: Process, People, Performance, Price, and Parent. The first four P's are specific to an individual fund or global equivalent.

The Parent pillar, however, is a holistic look at the firms offering the funds and reflects Morningstar's assessment of those firms as stewards of investors' capital. Including this assessment in the Morningstar Analyst Rating is a nod toward Morningstar's past studies indicating that firms with strong stewardship characteristics tend to produce good fundholder experiences for investors, as measured by survivorship and superior long-term results, particularly on a risk-adjusted basis.

Parent Coverage and Parent Data Details

Morningstar assigns a Parent rating to every mutual fund firm represented in its Morningstar Analyst Ratings. In the U.S., this includes 179 mutual fund companies as of Dec. 31, 2013. Some of these firms have global operations, while others are limited to the U.S. (or Morningstar's coverage is limited to U.S. investment vehicles).

To grade mutual fund parent companies, Morningstar has developed several firm-level data points, which will be discussed in this paper. These include statistics on manager tenure and manager retention, manager incentives, and fees. These data points are calculated on more than 750 U.S. firms offering mutual funds, whether or not they are assigned a Parent rating or Stewardship Grade.

Determining the Parent Ratings and Stewardship Grades

Morningstar puts every mutual fund parent firm it covers through its stewardship methodology to determine a Parent rating and/or Stewardship Grade. As noted above, that methodology examines five areas that Morningstar expects to have the most impact on a firm's stewardship practices: (1) the corporate culture of the parent company; (2) the quality of the board of directors overseeing the company's funds; (3) the fund managers' financial incentives; (4) the firm's Average Fee Level; and (5) the firm's regulatory history. The methodology combines quantitative and qualitative inputs.

For the 20 largest asset managers by mutual fund assets, those that are assigned a Stewardship Grade, Morningstar publishes letter grades—A, B, C, D, or F—for each of the five components as well as an overall letter grade. For firms that are assigned a Parent rating, Morningstar gives them a Positive, Neutral, or Negative overall rating. There is a direct relationship between a firm's Stewardship Grade and its Parent rating; firms with a Stewardship Grade of A or B receive a Positive Parent rating, those with a C receive a Neutral Parent rating, and those with a D or F receive a Negative Parent rating.

State of the Industry: Firm-Level Data Points

Morningstar's firm-level data, calculated for more than 750 U.S. companies offering mutual funds, measure the asset-management firms on several key mutual fund metrics, including manager tenure, manager retention, and investment in fund shares. The data also measure fund cost and put it in context relative to similar strategies with similar distribution schemes. This section of the paper examines this data across all firms for which they are calculated, identifying trends and examining the relationship between firm-level data and investor outcomes.

Manager Tenure

Manager tenure tells investors how long, in years, a portfolio manager has been assigned to a particular mutual fund. It's important for various reasons, not the least of which is its relevance to the evaluation of fund performance. In many cases, a fund's published total returns and performance behavior are relevant only during a manager's tenure, particularly in instances where just one manager is at the helm. In addition to potential changes in performance, manager changes can also coincide with a change in fund strategy. Manager tenure also provides signals from a stewardship perspective and is incorporated into Morningstar's assessment of a fund company's corporate culture. Generally, longer manager tenure indicates that things are going well and that both the fund company and fund manager are satisfied.

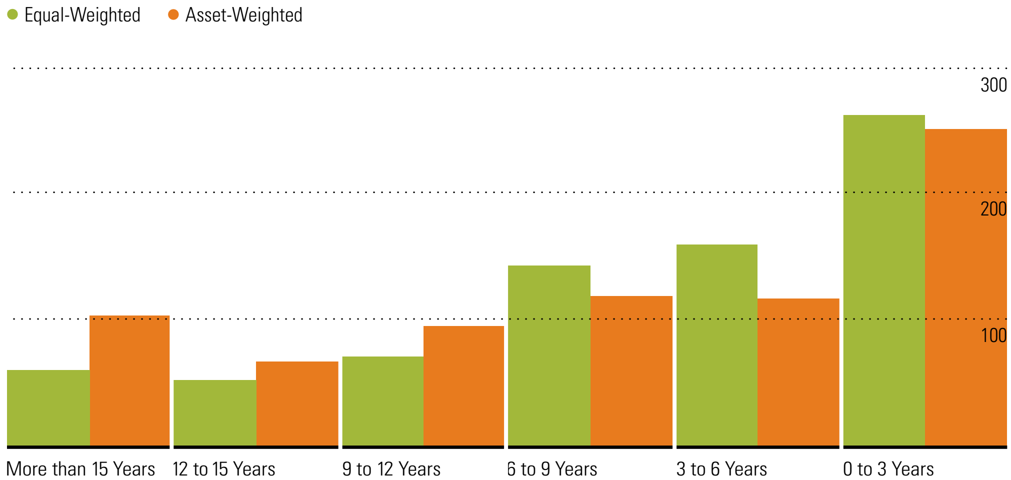
It could also give clues as to the level of patience a fund company has in the face of weaker returns. There is no right answer on this note, and the appropriate level of patience could depend on the market environment and type of strategy undertaken. That being said, while some turnover in manager ranks, as indicated by shorter manager tenures, could subsequently lead to better results (some turnover is good turnover), it could indicate the fund company is having trouble putting the right people on the job.

Finally, short average manager tenures can also result when a slew of new funds are being launched and/or others are being merged or liquidated. This kind of fund churn can be disruptive to investors and brings into question a fund company's motives.

As is the case with many data points, it can be necessary to take a deep dive behind the numbers to determine root causes, but longer manager tenure is generally more indicative of a stronger corporate culture than shorter manager tenure.

The figure below keys in on the tenure of the portfolio manager who has been named on the fund by its prospectus the longest. To come up with a firm-level number for tenure, Morningstar averages each fund firm's tenure figures, both as an equal-weighted average and as an asset-weighted average. The asset-weighted figures tell whether a fund company's larger funds have longer-tenured managers.

Exhibit 1 Firm Count by Firm Average Longest Manager Tenure



Source: Morningstar, Inc. as of 12/31/2013

Both on an equal-weighted and an asset-weighted average basis, average manager tenure skews to the short end of the tenure spectrum, with more average manager-tenure figures landing in the 0 to 3 years range by a significant margin. This short tenure profile supports a couple of observations about the mutual fund industry. One, there has long been a greater emphasis in the fund industry on three-year returns, both at the institutional-client level and as part of manager-compensation programs. (There has been more-recent movement toward a greater emphasis on five-year returns.) These numbers illustrate the notion that there is much manager-change activity, likely in part as a result of disappointing fund performance. It also supports the assertion that the fund industry remains a "free-agent" market, with portfolio managers easily able to move freely among asset managers. Finally, the numbers reflect the manufacturing aspect of the fund industry; many short tenures merely reflect portfolio managers' assignment to new "product" for mutual fund consumers.

It isn't surprising to see the numbers shift slightly on an asset-weighted basis. Funds that have endured and gathered assets are likely to have posted competitive returns, and more fund families have longer asset-weighted manager-tenure averages, reflecting that they've kept portfolio managers on such funds for a longer period of time. However, even on an asset-weighted basis, more firms land in the shortest average manager-tenure range.

Exhibit 2 Morningstar Success Ratios by Firm Average Longest Manager Tenure Equal-Weighted

	Average Morningstar Success Ratio			Average Morningstar Risk-Adjusted Success Ratio			Firm Count	
	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year	Minimum	Maximum
More than 15 Years	45	37	35	42	40	36	62	62
12 to 15 Years	36	34	34	40	33	35	54	54
9 to 12 Years	40	38	34	41	37	38	66	72
6 to 9 Years	42	40	37	41	38	36	109	146
3 to 6 Years	37	35	32	38	33	34	80	164
0 to 3 Years	36	31	15	37	29	13	12	56

Source: Morningstar, Inc. as of 12/31/2013

Exhibit 3 Morningstar Success Ratios by Firm Average Longest Manager Tenure Asset-Weighted

	Average Morningstar Success Ratio			Average Morningstar Risk-Adjusted Success Ratio			Firm Count	
	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year	Minimum	Maximum
More than 15 Years	45	41	36	44	43	36	102	102
12 to 15 Years	38	38	39	40	35	39	69	69
9 to 12 Years	42	37	38	43	36	41	90	97
6 to 9 Years	39	35	30	38	33	29	71	121
3 to 6 Years	39	38	26	40	37	29	40	119
0 to 3 Years	27	22	8	27	17	5	11	46

Source: Morningstar, Inc. as of 12/31/2013

According to the data, fund families with average manager tenures in the longest (more-than-15-years) bucket beat out those with averages in the two shortest buckets (0 to 3 years and 3 to 6 years). This is true when considering both Morningstar Success Ratio and Morningstar Risk-Adjusted Success Ratio, and particularly true on a risk-adjusted basis as the time period extends.

That the two lowest average manager-tenure ranges correspond with a lower Morningstar Success Ratio could be explained in part by poor performance driving a manager change. It's also worth noting that there are a more limited number of observations in this camp, as the firm count in the table shows; the peer groups for each time period are substantively smaller than when looking at the other manager-tenure buckets. This reflects the large number of new fund families whose funds have not yet earned a three-year performance record or, thus, a three-year Morningstar Success Ratio.

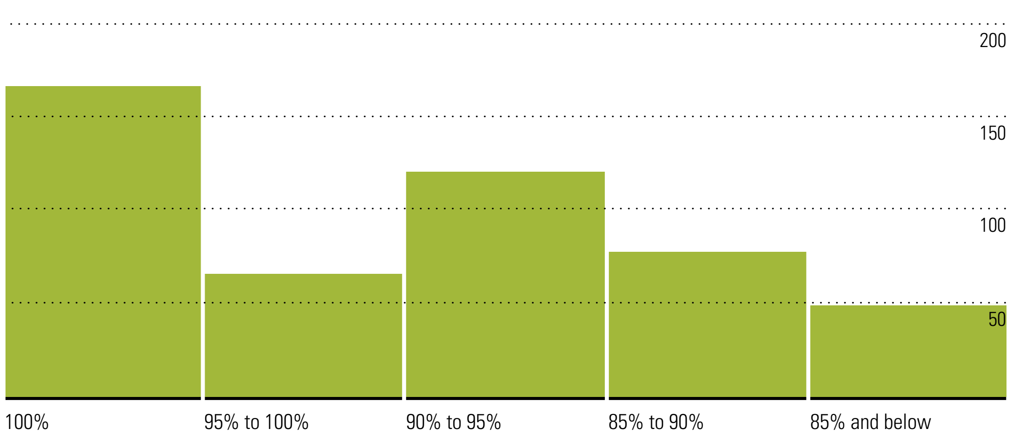
Manager-Retention Rates

Morningstar also measures manager-retention rates to give investors an idea of how effective an asset-management company has been at retaining its mutual fund portfolio managers. The manager-retention rate measures what percentage of a firm's portfolio managers have stayed at the company in a portfolio-manager capacity (specifically, named on one or more of its mutual funds) over a certain period of time. Morningstar calculates this figure for firms annually and also determines a five-year average. A lower number suggests more churn in the fund-manager ranks, though it doesn't necessarily mean that managers who have been removed from a firm's mutual funds aren't still working at the company in another capacity, such as in a senior management role or managing non-mutual-fund strategies.

Nonetheless, as was noted in the section on average manager tenure, disruption at the fund level can still be unsettling for its investors, as different managers can bring different portfolio-management acumen and investment approach to a fund. That's true even when former portfolio managers take on different duties at the same firm.

As they do with average manager tenure, Morningstar analysts use manager-retention rates as a signal about a firm's corporate culture. Strong corporate cultures are able to both attract and nurture investment talent and to foster an environment that's supportive of careers in portfolio management at the firm. Morningstar analysts combine this retention figure with their knowledge about investment professionals' careers at each company to help make a qualitative assessment about a fund firm's corporate culture.

Exhibit 4 Maximum Firm Count by Morningstar Five-Year Manager-Retention Rate



Source: Morningstar, Inc. as of 12/31/2013

Industry manager-retention data show that most firms are fairly stable. Roughly half of the 481 mutual fund firms that have at least one fund with a five-year track record show a five-year manager-retention rate between 95% and 100%. The great majority of these firms, nearly three fourths, have retention rates greater than 90%. Given this skew toward high five-year manager-retention rates, investors should take particular note of firms with five-year manager-retention rates below 90% to determine the underlying causes of their weaker retention rates.

Exhibit 5 Morningstar Success Ratios by Morningstar Five-Year Manager-Retention Rate Range

Morningstar Five-Year Manager-Retention Rate	Average Morningstar Success Ratio			Average Morningstar Risk-Adjusted Success Ratio			Firm Count	
	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year	Minimum	Maximum
100%	40	40	38	40	38	39	107	167
95% to 100%	48	42	40	50	43	43	59	66
90% to 95%	40	36	32	38	36	33	100	121
85% to 90%	38	34	30	41	31	27	72	78
85% and below	34	29	28	32	26	31	43	49

Source: Morningstar, Inc. as of 12/31/2013

The industry data show that there is a positive relationship between higher five-year manager-retention rates and better Morningstar Success Ratios and Risk-Adjusted Success Ratios. This pattern holds over the three-, five-, and 10-year periods. The data indicate that mutual fund parent companies that are able to better retain their portfolio managers in a portfolio-management capacity have also produced better outcomes for fundholders.

That being said, while 100% manager retention leads to superior success ratios, a little disruption in the portfolio-manager ranks looks even better; that is, the 95% up to but not including 100% manager-retention bucket goes with the strongest average success ratio. These data support the idea that investors should consider firms with higher manager-retention rates when deciding with which fund companies to invest.

Manager Ownership of Fund Shares

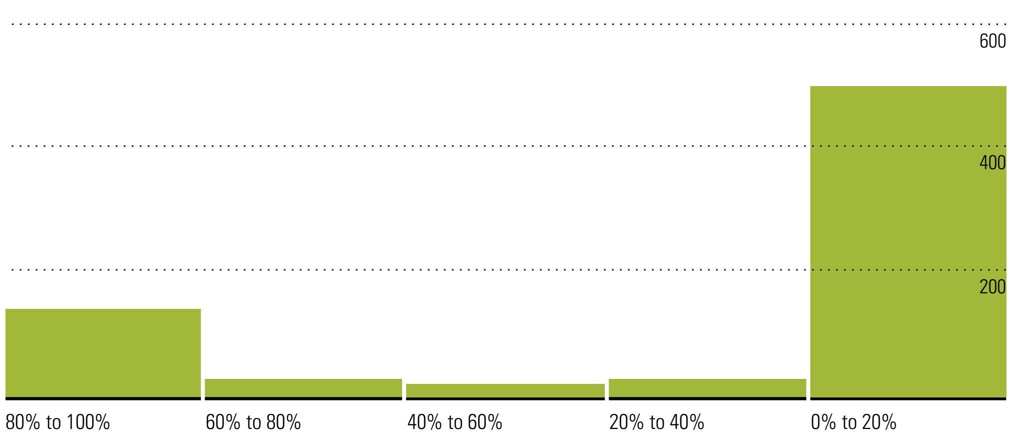
Beginning in 2005, the SEC required mutual funds to annually disclose how their portfolio managers were compensated as well as how much the managers invested in the funds they oversee. Manager ownership of fund shares is reported in a fund's Statement of Additional Information in the following ranges: zero; $0 -$10,000; $10,001-$50,000; $50,001-$100,000; $100,001-$500,000; $500,001-$1,000,000; and more than $1 million.

These ranges don't shed any light on how significant a portfolio manager's investment in fund shares is relative to his or her personal wealth. Nor do they consider a portfolio manager's asset allocation or personal financial goals. Furthermore, it may not always be reasonable to expect portfolio managers to invest more than $1 million in particularly specialized funds. Nonetheless, the more-than-$1-million level is the highest range required to be disclosed by the industry's regulator, and Morningstar considers it a best practice to meet that range. Portfolio managers who invest alongside their fundholders show a conviction in their investment approach and a confidence in their investment acumen. They are also better able to share in a true fundholder experience as they endure the same tax and cost consequences as their shareholders. Over the past decade, Morningstar has studied the impact of manager ownership several times, including in the 2011 Stewardship Grade Study. These studies show that funds with managers who "eat their own cooking" by investing alongside their fundholders run funds with better-performing records and lower fees than those with more-limited or no coinvestment with shareholders. This is particularly true on a risk-adjusted basis, suggesting that managers with a large financial interest in their funds are less likely to take greater risk with the portfolios they oversee.

For these reasons, Morningstar considers how heavily and predominantly a fund family's managers invest in the funds they oversee when it assigns Parent ratings or Stewardship Grades. To assess this level of investment, Morningstar uses a firm-level data point that considers what percentage of firm fund assets is in funds in which at least one portfolio manager has at least $1 million invested in the fund. This data point is calculated for all U.S. mutual fund parent companies.

In judging a fund firm's managers' level of commitment, Morningstar considers firms with more than 80% of assets in funds where at least one portfolio manager has invested more than $1 million to have a high level of ownership; those with 60%-80% of assets in funds where at least one portfolio manager has invested more than $1 million have notable level of ownership; and so on down to those with a low level of ownership, defined as 0%-20% of assets in funds with manager investment of more than $1 million.

Exhibit 6 Firm Count by Percentage of Firm Fund Assets with High Manager Ownership of Fund Shares



Source: Morningstar, Inc. as of 12/31/2013

While the industry data show one concentration at the top of the band—where 80%-100% of assets are invested in funds in which at least one manager has more than $1 million invested—they also show a disturbing concentration at the bottom of the range. This lowest band incorporates firms in which 0%-20% of assets are invested in funds in which at least one portfolio manager has more than $1 million invested. In fact, underlying this figure are 138 firms with portfolio managers who have made zero investment.

That being said, some firms have recently made efforts to increase manager ownership in their own charges. Time will tell whether the industry data improve.

Exhibit 7 Morningstar Success Ratios by Percentage of Firm Fund Assets with High Manager Ownership of Fund Shares

	Average Morningstar Success Ratio			**Average Morningstar Risk-Adjusted Success Ratio**			**Firm Count**	
	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year	Minimum	Maximum
80% to 100%	49	46	46	52	45	50	84	116
60% to 80%	42	43	35	45	45	34	25	27
40% to 60%	39	39	37	39	38	37	16	20
20% to 40%	40	33	32	42	34	30	28	28
0% to 20%	37	34	30	36	33	31	223	339

Source: Morningstar, Inc. as of 12/31/2013

The firmwide data alone support Morningstar's findings from other manager-ownership studies that show heavy manager ownership tends to produce better outcomes for fund investors. Mutual fund families with high collective manager ownership coincide with superior firm success ratios. This is particularly true on a risk-adjusted basis. In some cases the margin of victory is slight, but across the board, fund companies with 80%-100% of assets in funds in which at least one manager has more than $1 million invested in his or her fund(s) report the best success ratios. Those in the 0%-20% range tend to have the worst success ratios.

There is some limitation in interpreting the industry data, because it's not clear from these figures what the ownership levels were at the beginning of the time periods being considered for the success ratios. However, the manager ownership data tend to change slowly and gradually.

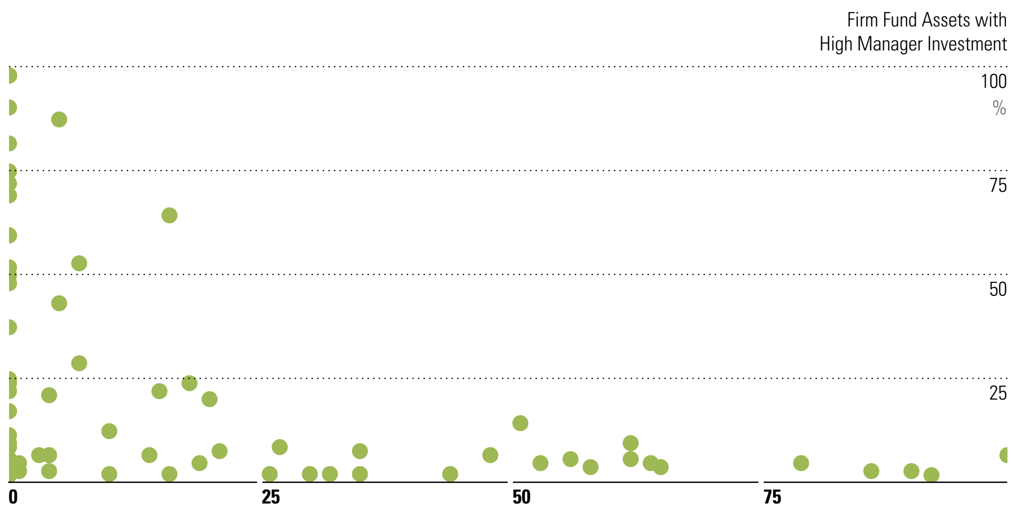
Manager Ownership of Fund Shares: Passive Strategies

Passive strategies, predominantly index funds, present a special challenge when it comes to manager investment in funds. That's because index-fund managers tend to be named on multiple offerings and tend to have more-limited upside in terms of compensation. Unlike active portfolio managers, they aren't paid huge bonuses to beat the market or their index; rather, they're typically judged by how closely they match an underlying benchmark.

Further, management fees charged on passively managed and index funds are smaller than those associated with actively managed funds. As such, one would expect to see lower levels of manager investment in passive fund shares—especially at the highest levels—and the data bear that out.

That's not to say that passive or index managers should be let off the hook when it comes to manager ownership. Any investment in fund shares demonstrates a conviction in index strategies generally and the sensibility of the passive or index offering specifically. Investing in their charges gives managers the same tax and cost consequences as their fundholders, which are always important to investors.

Exhibit 8 Relationship between Percentage of Firm Fund Assets in Passive Strategies and Percentage of Firm Fund Assets with High Manager Ownership of Fund Shares



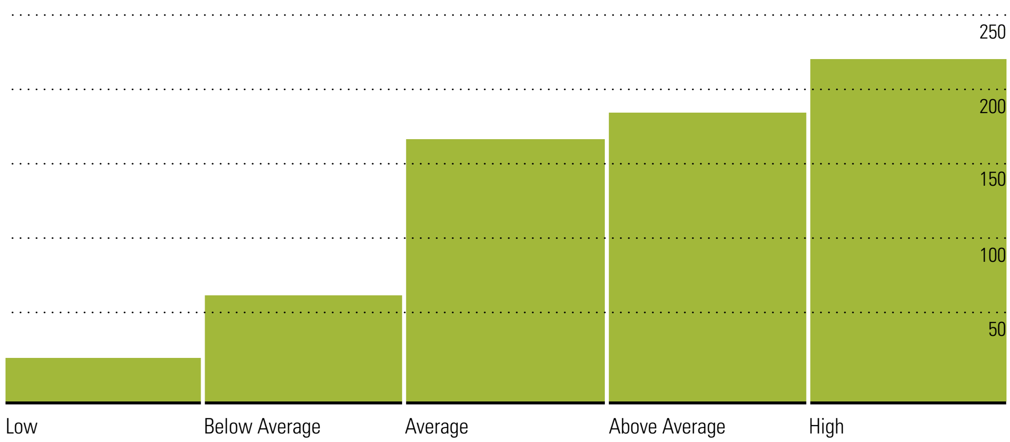
Firm Fund Assets in Index and Enhanced Index Funds (only values greater than 0% plotted)
Source: Morningstar, Inc. as of 12/31/2013

Exhibit 8 depicts only fund families that have some level of assets invested in index or enhanced-index offerings (excluding exchange-traded funds). Firms with predominantly active funds but still some number of passive funds have varying percentages of assets in funds in which one manager has more than $1 million invested. However, those with more than about 20%-25% of assets in index or enhanced-index funds have low levels of portfolio manager investment in funds. The data bear out some of the issues cited above.

Morningstar Fee Level

A firm's Average Morningstar Fee Level—Distribution is simply the arithmetic mean of all of a firm's individual funds' Morningstar Fee Level rankings for each mutual fund share class. To determine an individual share class' Morningstar Fee Level, Morningstar first creates peer groups both by supercategory (large-cap U.S. stock, for example) and by distribution channel (front-end sales charge). Once a share class is placed in the appropriate grouping, its expense ratio is ranked against its fee-level peers. Those with expenses in the cheapest quintile receive a Morningstar Fee Level of Low, those in the next quintile Below Average, then Average, Above Average, and High for the next three quintiles. The fee rankings of all the share classes of all a firm's funds are then averaged to compute the firm's Morningstar Average Fee Level—Distribution.

Exhibit 9 Firm Count by Average Morningstar Fee Level—Distribution



Source: Morningstar, Inc. as of 12/31/2013

There are many more firms with Average Fee Levels of Average to High than there are with levels of Low and Below Average. That's because relatively few firms have been able to offer lower-cost funds across the board. This is likely the result of varying asset levels and scale. In the Average Fee Level calculation, small funds count just as much as larger ones. Even those firms with very attractively priced flagship or core funds can quickly move into the Average camp when smaller and newer funds are included in the calculation. Furthermore, although Morningstar has created many varied distribution-channel segmentations in order to make appropriate comparisons, the peer groups are large and quantitatively driven and sometimes include significant outliers.

Exhibit 10 Morningstar Success Ratios by Average Morningstar Fee Level Distribution

	Average Morningstar Success Ratio			Average Morningstar Risk-Adjusted Success Ratio			Firm Count	
	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year	Minimum	Maximum
Low	56	54	54	54	52	53	14	17
Below Average	48	45	40	51	43	45	46	53
Average	42	37	38	43	38	39	131	154
Above Average	45	40	36	44	35	36	105	158
High	27	29	19	28	30	20	86	170

Source: Morningstar, Inc. as of 12/31/2013

Nonetheless, Morningstar's research has consistently indicated that a mutual fund with low fees is more likely to have superior relative results in the future. Rolling up fee data to the firm level supports this link between lower fees and better success. Exhibit 10 shows that firms with Low and Below Average Fee Levels show stronger Morningstar Success Ratios and Morningstar Risk-Adjusted Success Ratios.

This conclusion holds over the three-, five-, and 10-year periods ended Dec. 31, 2013. While there is generally improvement in success ratios as the Average Fee Level improves, firms with High Fee Levels show success ratios that are meaningfully inferior to those of firms with better Average Fee Levels.

One explanation is that funds with high fee levels lack scale to lower their expense ratios. These expensive funds are less likely to have the strong performance needed to attract investors and thus are more likely to be merged away or liquidated. That would have a detrimental effect on success ratios.

Another important note in examining these data is that a firm's Average Fee Level reflects fees as of Dec. 31, 2013—not the fees at the start of each of the three time periods assessed. Often, however, a firm's fee philosophy is baked into its corporate culture, and thus a firm's Average Fee Level is unlikely to change dramatically.

Firm Size

While Morningstar does not consider an asset manager's size by assets or number of funds in its assessment of Parent or Stewardship, the context does inform opinions about corporate culture and often sparks questions about whether there are inherent advantages or disadvantages of investing with firms that are large or small, specialists or generalists.

The first two exhibits below look at firms bucketed by five different asset-level breakpoints: more than $100 billion in open-end mutual fund assets; $25 billion to $100 billion; $1 billion to

$25 billion; $100 million to $1 billion; and less than $100 million. The "more than $100 billion" category encompasses the largest 18 U.S. firms by mutual fund assets, the second grouping the next 43 fund families. The third bucket is the largest and most diverse group, including both broad firms with offerings in multiple asset classes as well as companies with distinct investment-style biases. The two smallest buckets include many firms with limited numbers of offerings or strategies.

The second two tables also address fund size, but instead of using total net mutual fund assets, they consider the number of funds each company offers. Those five groupings include firms with more than 50 funds (excluding share classes), 11 to 50 funds, 6 to 10 funds, 2 to 5 funds, and 1 fund. As is the case when using a firm's level of assets as a gauge for fund size, firms with more than 50 offerings are broad-based, with fund lineups often running the investment-mandate gamut. The two smaller groupings, 2 to 5 funds and 1 fund, are typically investment specialists, often offering just one investment approach, perhaps with slightly different applications (such as one large-cap and one small-cap fund). In a slight contrast to the asset-size breakdown, these smaller two groupings represent the vast majority of fund firms, illustrating the preponderance of "boutique" investment shops as well as the relatively low barriers to entry to the mutual fund industry.

Exhibit 11 Morningstar Firm-Level Data by Firm Size

		Firm Average Longest Manager Tenure Years					**Firm Count**	
Total Firm Fund Assets USD	Average Firm Assets USD	Equal-Weighted	Asset-Weighted	Morningstar Five-Year Manager-Retention Rate %	Firm Fund Assets with High Manager Ownership of Fund Shares %	Average Morningstar Fee Level Distribution Percentile Rank	Minimum	Maximum
More than 100B	408,861,259,343	8.3	12.5	91.21	45	36	18	18
25B to 100B	54,450,513,124	7.4	10.7	90.91	37	51	42	43
1B to 25B	6,115,085,833	8.1	10.6	93.01	35	58	147	178
100M to 1B	359,019,938	6.9	7.7	95.05	23	67	93	212
Less than 100M	34,238,658	5.5	5.6	95.78	17	77	62	270

Source: Morningstar, Inc. as of 12/31/2013

Exhibit 12 Morningstar Ratings and Success Ratios by Firm Size

Total Firm	**Firm Average Morningstar Rating**				**Average Morningstar Success Ratio**			**Average Morningstar Risk-Adjusted Success Ratio**			**Firm Count**	
Fund Assets USD	3-Year	5-Year	10-Year	Overall	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year	Minimum	Maximum
More than 100B	3.13	3.27	3.16	3.24	52	51	47	50	50	45	18	18
25B to 100B	3.10	3.09	3.13	3.16	49	42	41	47	43	38	42	43
1B to 25B	3.09	2.98	3.10	3.12	47	41	42	47	41	42	147	178
100M to 1B	2.81	2.80	2.79	2.86	37	39	32	39	37	34	95	212
Less than 100M	2.46	2.31	2.24	2.36	31	26	14	31	24	18	62	270

Source: Morningstar, Inc. as of 12/31/2013

Exhibit 13 Morningstar Firm-Level Data by Number of Fund Offerings

Firm Number of Fund Offerings	Average Number of Funds	Average Firm Assets USD	Firm Average Longest Manager Tenure: Equal-Weighted	Firm Average Longest Manager Tenure: Asset-Weighted	Morningstar Five-Year Manager-Retention Rate %	Firm Fund Assets with High Manager Ownership of Fund Shares %	Average Morningstar Fee Level Distribution Percentile Rank	Firm Count: Minimum	Firm Count: Maximum
Over 50 Funds	92	210,989,824,673	7.1	10.0	89.78	27	44	39	39
11 to 50 Funds	24	18,233,894,748	6.9	9.4	90.41	20	57	82	93
6 to 10 Funds	8	6,191,896,009	7.8	9.9	93.72	29	62	64	86
2 to 5 Funds	3	1,746,747,530	6.3	7.7	95.31	24	70	131	243
1 Fund	1	233,214,095	6.1	6.1	96.31	27	72	83	312

Source: Morningstar, Inc. as of 12/31/2013

Exhibit 14 Morningstar Ratings and Success Ratios by Number of Fund Offerings

Firm Number	Firm Average Morningstar Rating				Average Morningstar Success Ratio			Average Morningstar Risk-Adjusted Success Ratio			Firm Count	
of Fund Offerings	3-Year	5-Year	10-Year	Overall	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year	Minimum	Maximum
Over 50 Funds	2.99	3.02	2.93	3.03	48	42	37	44	39	33	39	39
11 to 50 Funds	2.86	2.79	2.90	2.87	40	34	31	39	33	31	83	93
6 to 10 Funds	2.97	3.03	2.97	2.99	44	45	42	44	46	38	65	86
2 to 5 Funds	2.84	2.72	2.94	2.84	40	36	34	41	36	40	105	243
1 Fund	2.64	2.61	2.63	2.62	34	34	29	36	32	32	78	312

Source: Morningstar, Inc. as of 12/31/2013

Considering both asset levels and number of offerings, the data show that smaller firms have generally been better at manager retention. This is in part because many of the smaller companies use an owner-operator or partnership model, in which the investment personnel are either sole proprietors or otherwise have some ownership interest in the firm. Because the exhibits consider five-year manager-retention rates, firms that don't yet have funds with five-year records are excluded from this observation.

Otherwise, the data generally favor the larger companies. Not only do they tend to have better Average Fee Levels—not surprising considering the scalability of the investment-management business—but they also have done a better job at extending manager tenures on funds, particularly on an asset-weighted basis. Larger firms by asset size also report, on average, a higher portion of assets in funds in which at least one portfolio manager has more than $1 million invested. The same can't be said, however, of larger firms by fund count; regardless of whether a fund company sponsors one fund or more than 50 funds, the percentage of assets in which at least one portfolio manager has more than $1 million invested lies in the 20% to 30% range—disappointing overall.

Furthermore, the larger firms by assets exhibit stronger performance data. They have higher Firm Average Morningstar Ratings, Morningstar Success Ratios, and Morningstar Risk-Adjusted Success Ratios over all time periods calculated.

There are a couple of observations to be made considering the performance data, however. One, larger firms, particularly by fund count, tend to have various investment styles, which can balance performance for the firm overall. It's thus not surprising to see the fund families with more mutual funds show a Firm Average Morningstar Rating of close to 3 stars. Meanwhile, smaller firms by fund size are generally more vulnerable to their investment style being out of favor, and so their relative-performance statistics can be more-volatile. On the fund-offerings table, there's more variation in the rank order of Firm Average Morningstar Rating, for example, which may reflect style biases, though the tables show the very smallest fund families both by assets and number of offerings (firms with less than $100 million in assets and 1-fund companies) have inferior performance figures across the board.

The second observation reflects an often-seen investor-behavior pattern. Investors tend to buy funds based on recent past performance. That larger firms have stronger longer-term returns supports the assertion that investors have chosen their investment managers well (if not timed their purchases or asset-allocation choices well) and in turn those companies have grown to be the industry's largest. It's also worth noting that larger firms have bigger marketing budgets.

Correlations of Firm-Level Data
This paper has so far examined individual stewardship characteristics at the industry level. The following table shows the correlation among the various statistics discussed in detail, plus three more: firm growth rate over the past five years, fund launches over the past five years, and fund liquidations and mergers over the past five years. Launches, liquidations, and mergers are addressed to some extent in Morningstar's Success Ratio and Risk-Adjusted Success Ratio calculations, which consider each fund family's number of offerings at the beginning and end of the calculation time period.

Correlation measures the existence of two variables together but doesn't always indicate causation. In evaluating the matrix, Morningstar considers generally accepted interpretations of correlation; specifically, a correlation between 0.0 and 0.1 (positive or negative) indicates no correlation, between 0.1 and 0.3 (positive or negative) suggests weak correlation, between 0.3 and 0.5 (positive or negative) medium correlation, and between 0.5 and 1.0 (positive or negative) strong correlation.

Exhibit 15 Correlations of Firm-Level Data

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1 Firm Average Longest Manager Tenure Equal-Weighted	1.00														
2 Firm Average Longest Manager Tenure Asset-Weighted	0.95	1.00													
3 Firm Manager-Retention Rate 1 Year	0.17	0.15	1.00												
4 Firm Manager-Retention Rate 5 Year	0.31	0.28	0.52	1.00											
5 Firm Fund Assets with High Manager Ownership of Fund Shares	0.28	0.33	0.09	0.26	1.00										
6 Firm Fund Assets in Index or Enhanced Index Funds	−0.01	−0.02	−0.01	−0.10	−0.11	1.00									
7 Firm Average Fee Level Percentile Rank	−0.02	−0.09	0.13	0.10	−0.08	−0.10	1.00								
8 Firm Total Fund Assets	0.03	0.10	−0.04	−0.06	0.07	0.15	−0.22	1.00							
9 Firm Number of Fund Offerings	0.02	0.12	−0.14	−0.26	0.01	0.21	−0.28	0.64	1.00						
10 Firm Average Morningstar Rating 5 Year	−0.05	0.01	0.05	0.05	0.17	−0.03	−0.19	0.09	0.10	1.00					
11 Firm Morningstar Success Ratio 5 Year	−0.02	0.03	0.15	0.10	0.15	−0.03	−0.16	0.08	0.05	0.76	1.00				
12 Firm Morningstar Risk-Adjusted Success Ratio 5 Year	0.01	0.06	0.13	0.12	0.16	−0.02	−0.16	0.08	0.04	0.80	0.87	1.00			
13 Firm Growth Rate 5 Year	−0.07	−0.08	0.04	0.01	−0.03	−0.02	0.04	−0.02	−0.04	0.11	0.13	0.13	1.00		
14 Firm Fund Launches Cumulative 5 Year	0.16	0.25	−0.13	−0.25	0.06	0.10	−0.27	0.53	0.89	0.06	−0.01	−0.01	−0.05	1.00	
15 Firm Fund Liquidations and Mergers Cumulative 5 Year	−0.05	0.03	−0.17	−0.30	0.04	0.06	−0.25	0.17	0.58	0.04	0.00	−0.01	−0.05	0.75	1.00

Correlation (positive or negative)

None	0.0 to 0.1
Weak	0.1 to 0.3
Medium	0.3 to 0.5
Strong	0.5 to 1.0

Source: Morningstar, Inc. as of 12/31/2013

Overall, the data show very limited correlation among almost all of the variables.

The strongest correlations present between variables that are related, almost by definition. For example, equal-weighted manager tenure and asset-weighted manager tenure show a correlation of 0.95. There is also a strong correlation between Average Morningstar Rating (5 year) and both Morningstar Success Ratio (5 year) and Morningstar Risk-Adjusted Success Ratio (5 year).

There are a couple of other interesting strong correlations. While it stands to reason that a greater number of fund launches over the past five years correlates strongly with fund assets and number of fund offerings, there is also a strong correlation between a greater number of fund launches over the past five years and a greater number of fund liquidations and mergers over the past five years. This may reflect a product-manufacturing mentality by the industry overall, in which the producers (asset managers) see little risk in presenting the market with new funds, as it's fairly easy to later remove them through a liquidation or, more likely, merger. (A liquidation would require the fund to return capital to fundholders, while a merger allows it to keep those assets in-house.)

Other seemingly obvious relationships exist, particularly when considering Average Fee Level. A High Average Fee Level (inferior) is negatively correlated, though only slightly so, with a high percentage of assets in index and enhanced-index offerings. There is a slightly stronger negative correlation between a High Average Fee Level and a larger asset level as well as various performance measures.

The correlations between a high percentage of assets in index and enhanced-index funds and certain other variables are also in line with expectations. For example, a large index business is negatively correlated with manager tenure, manager retention, and manager ownership of fund shares but positively correlated with the number of offerings a firm sponsors as well as total fund assets. Surely this latter correlation is supported by the existence and success of Vanguard, which has nearly $2 trillion in mutual fund assets.

Even those relationships, however, are fairly weak. That correlation is limited among most attributes signals that not one variable tells much about the others, and that each attribute is providing some unique information. High marks across multiple variables thus imply multiple sources of good stewardship practices and increase confidence in a positive stewardship assessment. At the same time, limited correlation may also indicate that it's tough to find the perfect fund company, at least one represented by all of the above traits. There may thus be trade-offs when considering firm-level data, which supports Morningstar's application of qualitative research in determining Parent ratings and Stewardship Grades.

Firm-Level Data by Morningstar Parent Ratings

Morningstar uses its firm-level data as part of its methodology for assigning Parent ratings and Stewardship Grades. Both ratings consider the same criteria: Corporate Culture, Fund Board Quality, Manager Incentives, Fees, and Regulatory History. The methodology relies on analysts' quantitative and qualitative assessments of these components.

To assess a firm's Corporate Culture, for example, analysts determine whether the firm is focused primarily on serving fundholders well, placing their interests before the firm's own corporate profits. Some data, including manager retention and manager tenure, help an analyst make such assessments, but a qualitative analysis of the strength and depth of the investment team and of the firm's distribution and product-development agenda plays an important role in arriving at a Corporate Culture grade for the firm. Similarly, to evaluate Fund Board Quality, analysts look at the board's track record, including its history on approving new funds, closing capacity-constrained strategies, and negotiating low fees on behalf of fundholders. Periodic interviews with fund board directors help the analysts understand the board's approach to its governance duties.

Even though much of the Parent rating and Stewardship Grade methodology is largely qualitative, analysts look to firm-level data to help them quantitatively assess firms, so there are predictably circular patterns to the data and Parent ratings; often firms with stronger firm-level data have higher Parent ratings and Stewardship Grades. As of Dec. 31, 2013, Morningstar rated 179 U.S. parent companies Positive, Neutral, or Negative. Twenty of the largest parent companies receive Stewardship Grades, which is reflected as a letter grade (A, B, C, D, or F) and includes more-comprehensive written analysis of the firm's stewardship of capital practices.

It is worth noting that there is significant selection bias in the universe of fund companies receiving Parent ratings from Morningstar, and even more so among the firms earning Stewardship Grades. Morningstar's analysts rate the industry's better, and also largest, funds. Even those earning poor marks are large or prominent enough to warrant broad attention from investors. Thousands of funds do not receive Morningstar Analyst Ratings, and these are arguably some of the industry's weaker offerings.

With these biases in mind, the Parent ratings and Stewardship Grades skew positively, with 43% of the 179 rated parents earning Positive ratings, 46% earning Neutral ratings, and just 11% earning Negative ratings as of Dec. 31, 2013. Of the 20 firms earning Stewardship Grades on Jan. 31, 2014, all received passing grades, with four earning A's, six earning B's, and 10 earning C's.

Positive-Rated Parents

All told, the 77 Positive companies had stronger firm-level data than the parents rated Neutral and Negative.

Exhibit 16 Morningstar Firm-Level Data for Positive-Rated Parents

	Firm Average Manager Tenure				
Firm	Equal Weighted Years	Asset Weighted Years	Morningstar Five-Year Manager -Retention Rate %	Firm Fund Assets with High Manager Ownership of Fund Shares %	Average Morningstar Fee Level–Distribution Percentile Rank
Absolute Strategies	6.8	8.2	100.00	100	82
Acadian Funds	11.0	18.5	88.62	97	53
Amana	16.0	21.5	92.84	100	68
American Beacon	9.9	19.4	95.40	27	56
American Funds	12.0	21.6	95.62	97	18
Appleseed Fund	7.0	7.0	100.00	100	68
AQR Funds	2.2	3.8	92.28	0	37
Arden Asset Management LLC	1.1	1.1	NA	NA	NA
Ariel Investments, LLC	9.0	19.4	97.44	99	62
Artisan	9.7	13.8	95.31	99	56
Aston	6.3	13.7	92.88	86	67
Berwyn	16.4	12.2	95.83	100	48
Bogle	14.2	14.2	100.00	100	75
Brandes	10.9	13.5	95.59	33	31
Bridgeway	11.2	12.2	96.55	18	17
Broadview Funds	16.2	16.2	95.83	100	59
Brown Capital Management	13.7	21.1	98.44	100	61
Causeway	6.3	11.4	100.00	91	64
Century Funds	10.6	12.9	94.73	87	77
Clipper Fund	7.9	7.9	100.00	100	25
Conestoga Capital Advisors	6.5	11.1	100.00	0	55
Davis Funds	13.0	17.5	94.80	99	30
Diamond Hill Funds	7.6	12.0	95.36	80	49
Dimensional Fund Advisors	7.4	9.9	94.73	0	7
Dodge & Cox	23.4	25.6	97.51	100	12
Driehaus	3.8	4.6	89.16	0	80
Fairholme	7.0	13.3	82.06	100	46
FAM	15.4	24.8	100.00	100	70
Fidelity Investments	4.8	8.5	91.13	51	33
First Eagle	7.7	6.9	91.35	96	51
FMI Funds	10.4	12.4	97.73	100	45
FPA	9.1	16.6	96.28	97	32
Franklin Templeton Investments	14.3	23.7	95.62	62	33
GMO	9.5	9.8	92.48	16	13
GoodHaven	2.7	2.7	NA	100	66

Exhibit 16 Morningstar Firm-Level Data for Positive-Rated Parents (Continued)

Firm	Firm Average Manager Tenure: Equal Weighted Years	Firm Average Manager Tenure: Asset Weighted Years	Morningstar Five-Year Manager -Retention Rate %	Firm Fund Assets with High Manager Ownership of Fund Shares %	Average Morningstar Fee Level–Distribution Percentile Rank
Greenspring	26.9	26.9	100.00	0	51
Harbor	6.5	11.8	92.72	86	57
Harding Loevner	10.0	12.5	94.56	0	67
Hotchkis and Wiley	10.1	13.5	100.00	100	54
Hussman Funds	7.6	12.0	100.00	99	33
Invesco	7.3	10.2	84.06	58	46
IVA Funds	5.3	5.3	100.00	100	36
Jensen	12.3	20.8	97.06	100	30
Kalmar Investments	16.7	16.7	92.84	100	82
Keeley	7.5	17.5	100.00	95	65
Leuthold	4.8	4.0	83.09	0	76
Litman Gregory Masters Funds	11.4	12.6	90.51	75	81
LKCM	11.6	15.2	97.31	68	58
Longleaf Partners	16.7	24.3	95.83	99	58
Loomis Sayles Funds	14.4	21.0	93.82	78	38
Mairs & Power	12.6	14.6	100.00	98	35
Manning & Napier	7.8	15.3	93.66	0	55
Matthews Asia Funds	5.5	6.1	92.85	0	41
Merger	6.9	6.9	92.84	100	18
Merk Funds	5.2	7.9	88.82	90	36
MFS	8.7	10.9	94.04	41	47
Natixis Funds	9.1	13.5	95.76	52	49
Neuberger Berman	5.9	11.7	95.17	74	49
Oakmark	15.1	17.9	92.04	100	66
Osterweis	9.1	12.3	97.44	19	64
Parnassus	9.3	12.6	97.96	96	50
PIMCO	5.5	15.5	91.90	48	48
PRIMECAP Odyssey Funds	9.1	9.1	96.55	100	15
Royce	10.7	22.5	97.78	97	67
Selected Funds	15.8	18.9	96.55	99	45
Sequoia	15.5	15.5	100.00	100	54
Sound Shore	28.6	28.6	100.00	100	46
T. Rowe Price	7.3	11.1	95.01	21	37
TFS Capital Funds	6.3	8.9	100.00	100	88
Third Avenue	10.3	8.9	93.74	77	71
Thornburg	6.0	11.5	93.65	73	50
Tweedy Browne	12.7	18.5	95.83	100	77
Vanguard	6.8	11.7	91.45	16	4
Vantagepoint Funds	8.4	9.3	88.79	0	29
Wasatch	8.6	11.6	96.67	87	68
Weitz	14.4	19.1	100.00	69	72
Westport Funds	16.0	16.0	100.00	100	85
Average for Positive Parents	**10.2**	**13.8**	**95.28**	**72**	**51**

Source: Morningstar, Inc. as of 12/31/2013

On average, the Positive-rated firms' open-end funds are run by managers named to the offerings for more than a decade, both on an equal-weighted and asset-weighted basis. More than a third of the Positive-rated firms have double-digit average manager tenures for the equal-weighted and asset-weighted averages.

The managers of funds at Positive-rated firms often have made significant personal investments in the funds they run. The Positive-rated firms have, on average, nearly three fourths of their assets in funds where at least one manager has high manager ownership, defined as more than $1 million invested alongside fundholders. Among the Positive-rated companies are many smaller firms that have very strong investment across a very limited lineup of funds, but these are at least somewhat offset by the half-dozen firms—including Dimensional Fund Advisors, one of the largest 20 fund companies—whose managers do not invest more than $1 million in any fund at the firm.

Many of the funds offered by Positive-rated firms also tend to be good value propositions. But the firms' average Morningstar Fee Level—Distribution was 51, near the center of the funds' respective peer groups, which have been grouped based on criteria such as load charges, minimum investments, and 12b-1 fees. Some of the Positive-rated parents with the highest overall fees are firms with unusual specialties, such as alternative strategies.

Exhibit 17 Morningstar Success Ratios for Positive-Rated Parents

	Morningstar Success Ratio			**Morningstar Risk-Adjusted Success Ratio**		
Firm	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year
Absolute Strategies	0	0	NA	0	0	NA
Acadian Funds	50	100	9	50	100	9
Amana	33	0	100	33	0	100
American Beacon	58	62	53	52	62	58
American Funds	62	60	62	62	64	67
Appleseed Fund	0	0	NA	0	0	NA
AQR Funds	93	NA	NA	93	NA	NA
Arden Asset Management LLC	NA	NA	NA	NA	NA	NA
Ariel Investments, LLC	67	100	50	33	67	0
Artisan	81	80	100	75	80	100
Aston	34	24	23	44	26	40
Berwyn	100	100	100	100	100	100
Bogle	100	100	100	100	100	0
Brandes	71	33	0	100	33	0
Bridgeway	73	40	8	64	50	0
Broadview Funds	100	100	100	100	100	100
Brown Capital Management	67	40	33	67	40	33
Causeway	100	100	100	100	100	100
Century Funds	20	0	0	20	25	33
Clipper Fund	100	100	0	100	100	0

Exhibit 17 Morningstar Success Ratios for Positive-Rated Parents (Continued)

	Morningstar Success Ratio			Morningstar Risk-Adjusted Success Ratio		
Firm	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year
Conestoga Capital Advisors	100	100	100	100	100	100
Davis Funds	15	56	32	17	58	19
Diamond Hill Funds	71	71	44	57	61	50
Dimensional Fund Advisors	61	77	81	59	63	65
Dodge & Cox	100	100	100	100	100	100
Driehaus	38	33	100	38	33	50
Fairholme	50	100	100	50	0	100
FAM	25	0	0	50	0	0
Fidelity Investments	48	57	40	40	49	32
First Eagle	62	43	95	71	71	100
FMI Funds	100	0	50	100	100	50
FPA	40	80	40	40	80	60
Franklin Templeton Investments	42	41	45	41	42	44
GMO	64	28	39	66	35	46
GoodHaven	NA	NA	NA	NA	NA	NA
Greenspring	0	0	100	0	0	100
Harbor	42	39	48	41	41	45
Harding Loevner	63	86	100	63	100	100
Hotchkis and Wiley	96	100	52	76	100	0
Hussman Funds	0	0	50	0	0	50
Invesco	24	23	24	23	26	27
IVA Funds	13	38	NA	75	38	NA
Jensen	40	0	0	80	0	100
Kalmar Investments	100	100	100	100	100	100
Keeley	100	50	100	72	25	50
Leuthold	7	20	100	8	22	100
Litman Gregory Masters Funds	14	60	25	14	60	25
LKCM	22	20	50	33	50	50
Longleaf Partners	67	67	33	33	67	33
Loomis Sayles Funds	73	85	58	87	100	63
Mairs & Power	100	100	100	100	100	100
Manning & Napier	45	44	77	56	40	77
Matthews Asia Funds	85	80	71	79	80	71
Merger	100	100	100	100	100	100
Merk Funds	50	50	NA	NA	NA	NA
MFS	57	60	40	56	58	41
Natixis Funds	59	54	58	51	52	48
Neuberger Berman	34	40	59	36	48	54
Oakmark	85	85	86	92	85	64
Osterweis	33	0	0	33	0	100
Parnassus	71	71	50	71	71	50
PIMCO	50	60	61	47	60	56
PRIMECAP Odyssey Funds	100	100	NA	100	100	NA
Royce	8	17	60	5	17	63
Selected Funds	0	0	0	0	0	0
Sequoia	100	100	100	100	100	100
Sound Shore	100	100	100	100	100	100
T. Rowe Price	78	82	82	76	83	82
TFS Capital Funds	100	100	NA	100	100	NA
Third Avenue	40	25	25	50	25	25

Exhibit 17 Morningstar Success Ratios for Positive-Rated Parents (Continued)

	Morningstar Success Ratio			Morningstar Risk-Adjusted Success Ratio		
Firm	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year
Thornburg	76	73	78	71	73	76
Tweedy Browne	100	33	50	100	67	100
Vanguard	75	61	78	79	65	78
Vantagepoint Funds	68	50	55	71	56	59
Wasatch	53	72	58	71	78	67
Weitz	86	86	40	86	86	40
Westport Funds	50	0	50	50	0	50
Average for Positive Parents	**60**	**56**	**59**	**61**	**58**	**59**

Source: Morningstar, Inc. as of 12/31/2013

The Positive-rated parents also have delivered better results for investors over the past three-, five-, and 10-year periods. The firms' Morningstar Success Ratios and Morningstar Risk-Adjusted Success Ratios are higher on average than those for Neutral- and Negative-rated parents, which are shown in later exhibits. More than half of the firms' funds survived and delivered peer-beating returns based on the funds' category ranks, which drive the Morningstar Success Ratio. The same is true for the firms' higher Morningstar Risk-Adjusted Success Ratio, which measures the percentage of funds that survived and produced a Morningstar Risk-Adjusted Return that beat their respective category median returns. These firms tend to be risk-aware, with their three- and five-year Morningstar Risk-Adjusted Success Ratios coming in higher than the success ratios for those periods that do not account for risk.

Neutral-Rated Parents

The Neutral-rated parent firm data are not as strong, on average, as those for the Positive-rated firms but exceed that of the Negative-rated parents.

Exhibit 18 Morningstar Firm-Level Data for Neutral-Rated Parents

	Firm Average Manager Tenure				
Firm	Equal Weighted Years	Asset Weighted Years	Morningstar Five-Year Manager-Retention Rate %	Firm Fund Assets with High Manager Ownership of Fund Shares %	Average Morningstar Fee Level-Distribution Percentile Rank
Aberdeen	4.9	7.4	86.04	13	58
Akre	4.3	4.3	NA	100	80
Alger	7.0	9.3	90.59	35	68
Allianz Funds	5.7	12.8	90.23	74	53
Altegris	1.9	2.5	NA	0	89
American Century Investments	7.3	10.5	92.12	0	53
Arbitrage Fund	5.9	12.7	100.00	0	46
Ashmore	2.5	3.0	NA	0	53
Ave Maria Mutual Funds	7.0	7.5	94.73	0	63
Baron Capital Group	8.5	15.8	97.44	95	69
BBH	5.2	6.3	91.95	57	44
BlackRock	4.9	12.3	86.15	65	47
Buffalo	10.0	13.4	97.39	16	55
Calamos	10.9	21.4	94.69	91	59
CGM	22.9	19.9	100.00	0	51

Exhibit 18 Morningstar Firm-Level Data for Neutral-Rated Parents (Continued)

	Firm Average Manager Tenure				
Firm	Equal Weighted Years	Asset Weighted Years	Morningstar Five-Year Manager-Retention Rate %	Firm Fund Assets with High Manager Ownership of Fund Shares %	Average Morningstar Fee Level-Distribution Percentile Rank
Champlain Funds	4.9	7.7	100.00	0	70
Cohen & Steers	7.4	7.6	91.32	0	50
Columbia	6.5	9.1	84.02	35	50
Credit Suisse (New York, NY)	3.7	8.0	79.17	26	46
Delaware Investments	9.3	10.1	90.03	19	59
Domini	5.7	4.9	92.47	0	74
DoubleLine	1.9	3.6	NA	92	58
Eaton Vance	7.2	11.7	92.26	34	51
Federated	10.6	12.0	92.10	19	57
Financial Investors Trust (Aspen)	2.3	2.3	NA	0	39
Forester	14.3	14.3	100.00	0	30
Hartford Mutual Funds	5.8	9.9	91.31	35	47
Heartland	12.4	13.2	94.53	25	45
Henderson Global	5.6	10.4	87.69	0	57
IndexIQ	2.8	2.8	74.83	NA	46
ING Funds	5.5	12.9	84.21	0	51
ING Retirement Funds	5.4	6.0	88.85	0	23
Janus	5.6	6.9	92.42	64	35
John Hancock	5.7	6.6	90.93	16	55
JPMorgan	6.9	10.5	93.86	56	34
Laudus Funds	5.4	5.7	86.96	34	58
Lazard	7.8	15.3	94.78	3	58
Legg Mason	7.7	12.6	94.22	44	50
Lord Abbett	7.0	10.6	87.85	55	34
MainStay	7.3	9.2	90.00	64	66
Managers Funds	9.8	16.7	91.60	68	59
MassMutual	6.7	8.9	88.83	4	45
Meridian	5.3	3.3	88.44	25	52
Metropolitan West Funds	10.6	15.9	100.00	10	41
Morgan Stanley	6.3	11.5	89.36	68	41
Munder	6.1	11.8	90.08	79	71
Mutualhedge	4.0	4.0	96.55	0	79
Northern Funds	6.4	6.9	89.07	0	26
Nuveen	6.5	8.8	89.67	1	49
OppenheimerFunds	6.4	9.4	87.64	64	40
Permanent Portfolio	10.6	10.6	100.00	100	62
Perritt	13.2	15.5	88.82	0	73
Pioneer Investments	8.1	12.8	90.07	40	61
Portfolio 21	14.3	14.3	87.76	0	70
Principal Funds	6.8	7.9	88.38	0	52
Prudential Investments	8.3	10.7	90.98	4	48
Putnam	7.2	7.3	89.36	26	48
Rainier	11.2	15.7	95.90	94	59
RidgeWorth	10.6	10.6	95.31	0	44
RiverPark Funds	3.7	3.2	100.00	45	72
Robeco Investment Funds	7.2	6.5	95.29	36	24.49
RS Funds	6.2	7.1	78.23	29	50
Russell	2.0	1.7	83.93	0	63
Schooner Funds	5.3	5.3	100.00	100	54

Exhibit 18 Morningstar Firm-Level Data for Neutral-Rated Parents (Continued)

	Firm Average Manager Tenure				
Firm	Equal Weighted Years	Asset Weighted Years	Morningstar Five-Year Manager-Retention Rate %	Firm Fund Assets with High Manager Ownership of Fund Shares %	Average Morningstar Fee Level-Distribution Percentile Rank
Schwab Funds	3.2	4.5	87.08	0	23
Scout	7.6	15.4	95.16	15	39
Sentinel	7.7	12.7	85.32	39	61
State Farm	9.8	13.1	88.97	0	44
Stratton	5.6	12.0	88.82	0	54
Swan	1.3	1.3	NA	100	34
TCW	4.8	5.4	89.69	30	57
Thomas White Funds	12.6	18.3	100.00	0	48
TIAA-CREF Mutual Funds	6.1	8.2	92.68	5	16
Tocqueville	14.8	17.8	89.95	62	73
Touchstone	7.5	9.4	86.84	23	48
Turner Funds	7.0	9.5	86.54	9	57
USAA	6.2	7.7	87.90	10	56
Van Eck	5.8	5.1	83.22	4	46
Victory	11.5	15.3	95.21	20	57
Virtus	4.9	9.5	82.88	32	72
Wells Fargo Advantage	7.9	9.3	91.81	20	49
Westwood	5.0	7.5	91.40	0	59
William Blair	5.9	4.9	97.59	16	65
Wintergreen Funds	8.2	8.2	100.00	100	95
Average for Neutral Parents	**7.1**	**9.6**	**91.17**	**30**	**53**

Source: Morningstar, Inc. as of 12/31/2013

Here the average manager tenure is just more than seven years on an equal-weighted basis and just less than 10 years on an asset-weighted basis—more than three years shy of the averages for the Positive-rated parents.

Compared with Positive-rated firms, manager ownership is also significantly less for Neutral-rated firms, with about 30% of the Neutral firms' assets in funds where at least one manager has more than $1 million invested in fund shares. The story is better on fund fees. The Neutral parents' average firm Morningstar Fee Level—Distribution is 53, just 2 percentage points higher than the Positive-rated firms' average.

Exhibit 19 Success Ratios for Neutral-Rated Parents

	Morningstar Success Ratio			Morningstar Risk-Adjusted Success Ratio		
Firm	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year
Aberdeen	13	14	17	18	12	15
Akre	100	NA	NA	100	NA	NA
Alger	36	38	44	32	45	43
Allianz Funds	26	25	23	24	22	22
Altegris	33	NA	NA	0	NA	NA
American Century Investments	51	23	31	47	25	31

Exhibit 19 Success Ratios for Neutral-Rated Parents (Continued)

	Morningstar Success Ratio			Morningstar Risk-Adjusted Success Ratio		
Firm	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year
Arbitrage Fund	100	100	100	100	100	100
Ashmore	40	NA	NA	50	NA	NA
Ave Maria Mutual Funds	50	17	50	50	33	50
Baron Capital Group	67	43	83	72	57	83
BBH	60	11	23	60	33	23
BlackRock	38	31	25	30	28	23
Buffalo	40	60	57	50	70	57
Calamos	14	44	28	15	43	25
CGM	0	33	75	0	33	25
Champlain Funds	100	0	NA	100	0	NA
Cohen & Steers	32	24	25	32	18	38
Columbia	28	21	18	24	18	16
Credit Suisse (New York, NY)	0	0	0	0	0	0
Delaware Investments	52	51	38	45	50	36
Domini	33	53	0	33	47	0
DoubleLine	67	NA	NA	67	NA	NA
Eaton Vance	39	40	17	36	40	22
Federated	47	25	29	42	25	26
Financial Investors Trust (Aspen)	NA	NA	NA	NA	NA	NA
Forester	0	0	0	0	0	100
Hartford Mutual Funds	55	51	34	49	47	31
Heartland	0	0	67	0	33	67
Henderson Global	39	37	75	26	34	75
IndexIQ	100	0	NA	100	0	NA
ING Funds	34	22	13	28	21	12
ING Retirement Funds	46	26	34	50	27	35
Janus	49	25	45	48	27	47
John Hancock	41	35	20	39	34	16
JPMorgan	56	46	36	47	44	34
Laudus Funds	59	8	5	65	8	5
Lazard	48	45	19	52	45	24
Legg Mason	53	46	18	48	44	15
Lord Abbett	41	44	43	37	41	39
MainStay	57	45	23	44	36	19
Managers Funds	39	33	26	38	34	21
MassMutual	57	45	50	50	40	49
Meridian	33	67	50	100	67	100
Metropolitan West Funds	87	100	82	87	100	73
Morgan Stanley	46	30	20	41	33	18
Munder	40	15	8	32	18	6
Mutualhedge	100	NA	NA	100	NA	NA
Northern Funds	36	16	21	37	14	17
Nuveen	37	42	42	34	39	39
OppenheimerFunds	40	49	30	41	46	31
Permanent Portfolio	50	25	50	50	0	50
Perritt	50	100	100	50	100	0
Pioneer Investments	23	26	23	22	24	21
Portfolio 21	0	0	0	0	0	100
Principal Funds	53	35	33	54	38	35
Prudential Investments	42	45	46	36	43	43

Exhibit 19 Success Ratios for Neutral-Rated Parents (Continued)

	Morningstar Success Ratio			Morningstar Risk-Adjusted Success Ratio		
Firm	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year
Putnam	52	53	33	37	45	23
Rainier	20	0	0	20	0	0
RidgeWorth	33	28	38	24	25	33
RiverPark Funds	40	NA	NA	40	NA	NA
Robeco Investment Funds	NA	0	0	NA	0	0
RS Funds	39	38	45	36	40	28
Russell	22	31	14	23	27	11
Schooner Funds	100	67	NA	50	67	NA
Schwab Funds	67	27	40	67	24	35
Scout	30	33	21	40	33	21
Sentinel	44	23	23	44	20	20
State Farm	27	4	17	20	4	17
Stratton	33	0	67	67	33	67
Swan	NA	NA	NA	NA	NA	NA
TCW	41	46	24	41	41	17
Thomas White Funds	33	50	50	33	50	50
TIAA-CREF Mutual Funds	89	65	48	86	63	39
Tocqueville	33	44	80	50	44	80
Touchstone	30	20	17	28	21	11
Turner Funds	13	11	17	13	22	17
USAA	66	63	69	67	69	69
Van Eck	47	92	89	32	75	67
Victory	29	21	33	27	28	22
Virtus	50	22	15	45	23	16
Wells Fargo Advantage	48	39	30	41	38	28
Westwood	40	30	100	40	30	100
William Blair	77	69	59	90	71	65
Wintergreen Funds	0	0	NA	0	100	NA
Average for Positive Parents	**44**	**34**	**36**	**43**	**36**	**36**

Source: Morningstar, Inc. as of 12/31/2013

The Morningstar Success Ratios for Neutral-rated fund firms, however, are significantly lower than those of the Positive-rated parents. Like the Positive parents, the shorter-term success ratios are strongest, but just 45% of the Neutral firms' funds survived and turned in three-year returns in their categories' top halves, on average, while nearly 60% of the Positive parents' funds met those criteria. The success ratios look worse for the Neutral parents' longer-term time periods, and the Morningstar Risk-Adjusted Success Ratios are all lower than the success ratios, suggesting the Neutral-rated parents haven't been as risk-aware as parents with stronger stewardship profiles.

Negative-Rated Parents

There are considerably fewer Negative-rated parent firms: just 18 of the 179 rated. (As explained above, the worst fund companies generally don't warrant qualitative coverage from Morningstar.) This smaller sample shows, however, that Negative parents have poorer firm-level data, on average, than Neutral- and Positive-rated parents.

Exhibit 20 Morningstar Firm-Level Data for Negative-Rated Parents

	Firm Average Manager Tenure				
Firm	Firm Average Tenure, Equal Weighted Years	Firm Average Tenure, Asset Weighted Years	Morningstar Five-Year Manager-Retention Rate %	Firm Fund Assets with High Manager Ownership of Fund Shares %	Average Morningstar Fee Level–Distribution Percentile Rankl
AllianceBernstein	9.8	11.1	84.86	12	42
Calvert Investments	4.7	5.3	86.63	0	69
Dreyfus	6.5	9.3	89.08	15	55
Dunham Funds	3.8	4.7	80.84	0	93
DWS Investments	6.2	9	82.83	3	53
Forward Funds	5.2	7.6	80.85	4	68
Gabelli	16.5	20.4	92.32	61	82
Goldman Sachs	6.5	8.1	85.98	28	51
Grant Park	1.4	2.6	NA	0	97
Guggenheim Investments	4.1	6.4	83.28	0	60
Hatteras Funds	1.9	3.2	84.42	0	95
Highland Funds	5.3	4.1	82.03	0	76
Ivy Funds	6.2	11.3	93.83	2	70
Marsico Investment Fund	9.3	9.7	94.82	54	89
Princeton	3.4	3.4	NA	NA	81
Quaker	9.8	14.3	94.38	65	85
UBS	7	8.2	85.72	0	54
Waddell & Reed	9.7	10.7	96.37	4	71
Average for Negative Parents	**6.5**	**8.3**	**87.39**	**15**	**72**

Source: Morningstar, Inc. as of 12/31/2013

For example, the managers assigned to funds offered by Negative parents are less experienced, having been on the job 6.5 years, on average in an equal-weighted test, and 8.3 years on average on an asset-weighted basis. That's about a year off from the Neutral-rated averages and significantly less experience on a fund than the managers at a firm rated Positive.

The managers of funds offered by Negative-rated firms also have less skin in the game, on average, than firms rated Neutral or Positive. About 15% of the Negative firms' open-end fund assets are run by at least one manager with more than $1 million invested. That's a full 60 percentage points lower than the average Positive-rated parent and half the average level shown by Neutral-rated parents.

Fees also are typically higher at Negative-rated firms. The average firm-level Morningstar Fee Level—Distribution for the Negative firms is 72, indicating that more than two thirds of the firms' fund peers have lower fees, on average.

Exhibit 21 Morningstar Success Ratios for Negative-Rated Parents

	Morningstar Success Ratio			Morningstar Risk-Adjusted Success Ratio		
Firm	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year
AllianceBernstein	29	35	24	29	32	18
Calvert Investments	50	28	9	43	26	9
Dreyfus	30	20	10	28	22	11
Dunham Funds	22	41	0	22	30	50
DWS Investments	33	29	17	33	27	16
Forward Funds	23	16	4	23	17	5
Gabelli	28	40	39	21	30	33
Goldman Sachs	45	40	23	42	37	23
Grant Park	NA	NA	NA	NA	NA	NA
Guggenheim Investments	16	33	24	18	29	17
Hatteras Funds	100	50	100	100	100	100
Highland Funds	31	17	5	33	21	3
Ivy Funds	30	36	48	27	35	48
Marsico Investment Fund	33	33	50	50	33	25
Princeton	0	NA	NA	0	NA	NA
Quaker	17	0	6	8	3	8
UBS	35	30	13	32	28	13
Waddell & Reed	45	38	60	41	33	58
Average for Negative Parents	**33**	**30**	**27**	**32**	**31**	**27**

Source: Morningstar, Inc. as of 12/31/2013

The Negative-rated firms also produced worse investment outcomes for their fundholders. The firms' Morningstar Success Ratios on average are less than 33% over all time periods, meaning that about two thirds of the firm's funds either did not survive or underperformed category peers—even on a risk-adjusted basis—over the three-, five-, and 10-year periods. The success ratio averages worsen considering longer time periods, with the 10-year success ratios a full 10 percentage points below the three-year figures, with 27% of assets deemed successful under either ratio measure. These data suggest that poor stewards of capital, as measured quantitatively by Morningstar's firm-level data, as well as more qualitatively through the Parent rating, have delivered poor returns for fundholders.

Parent Ratings and the Morningstar Rating

Morningstar Success Ratios are one way to measure firm performance. In addition, Morningstar also aggregates firm assets by the funds' Morningstar Rating, better known as the star rating. The star rating illustrates whether a fund has outperformed its category peers on a risk-adjusted basis, and it is quantitatively assigned to all funds with at least 36 months of performance and is updated monthly. Morningstar Ratings are calculated for the three-, five-, and 10-year periods as well as for an overall period, which places more emphasis on longer-term periods of performance.

By reflecting on the percentage of a fund firm's assets that are in 4- and 5-star funds, one can gauge whether a firm's typical fundholder earned peer-beating returns on a risk-adjusted basis. Arguably, this asset-weighted measure puts fund firms in a more favorable light because often a firm's largest funds have been among its best performers at one point or another. (Large funds can also be hindered by their asset bases, but typically assets follow performance.) Conversely, a firm's underperformers are more likely to have smaller asset bases and so will be counted less heavily in this calculation than in the Morningstar Success Ratios, which weigh each share class equally.

Exhibit 22 Percentage of Rated Parent Firms' Assets in 4- and 5-Star Funds

	Average Firm Fund Assets with Morningstar Rating							
Morningstar Parrent Rating	**3-Year**		**5-Year**		**10-Year**		**Overall**	
	4 Stars %	5 Stars %	4 Stars %	5 Stars %	4 Stars %	5 Stars %	4 Stars %	5 Stars %
Positive	24.76	18.76	26.08	16.65	23.92	20.87	34.77	15.46
Neutral	21.48	12.95	20.89	11.17	21.12	11.39	26.83	14.16
Negative	14.76	9.36	12.66	9.39	9.03	10.51	18.94	9.32

Source: Morningstar, Inc. as of 12/31/2013

Although the firms' Morningstar Success Ratios and the percentage of fund assets by Morningstar Rating tell different stories, their results are similar: Relative to Neutral and Negative firms, Positive-rated parents have both higher success ratios and higher percentages of assets in 4- and 5-star funds over all time periods. For example, among Positive-rated firms' funds with 10-year records on Dec. 31, 2013, about 45% of assets are in 4- and 5-star funds, while about 33% of Neutral-rated firm assets and 19% of Negative-rated firm assets are in similarly rated funds.

Parent Ratings by Morningstar Analyst Ratings

The tables above consider funds' past performance relative to their current Parent rating. It's also helpful to consider whether the firms' funds are likely to outperform in the future. The Morningstar Analyst Rating is forward-looking in this regard. When assigning the ratings, Morningstar analysts assign medals—ratings of Gold, Silver, or Bronze—to funds they deem likely to outperform peers on a risk-adjusted basis over a full market cycle.

Exhibit 23 Morningstar Parent Ratings by Percentage of Firm Fund Assets with Morningstar Analyst Ratings

	Firm Fund Assets with Morningstar Analyst Rating							
Morningstar Parent Rating	Medalist %	Gold %	Silver %	Bronze %	Neutral %	Negative %	Firm Fund Assets Not Rated %	Firm Count
Positive	78	23	34	21	5	1	15	77
Neutral	40	3	10	28	22	1	37	84
Negative	9	0	1	9	22	9	60	18

Source: Morningstar, Inc. as of 12/31/2013

To be sure, the Parent rating is one of five pillars that analysts consider when assigning this qualitative rating, so one would expect there to be overlap between firms earning Positive ratings and the firms' funds earning Morningstar Medalist Analyst Ratings. Indeed, the data above illustrate this trend. On average, parent firms earning Positive ratings have more than three fourths of their fund assets in funds earning Morningstar Analyst Ratings of Gold, Silver, or Bronze. Note also that relatively few assets at Positive-rated firms do not receive a Morningstar Analyst Rating.

Similarly, there are fewer assets in Medalists at the Neutral- and Negative-rated parent firms, and significantly less Morningstar analyst coverage of those firms' assets. The data also illustrate that Negative Parent ratings don't always impair funds from earning medals. About 9% of Negative-rated parents' assets, on average, are in funds that are Morningstar Medalists—about the same percentage of firm assets in Negative-rated funds. In these cases, the funds earning medals have other attributes that mitigate concerns about the parent firm, such as a strong subadvisor or an autonomous investment team.

Parent Ratings by Morningstar Fund Flows

Morningstar's fund-flows data also suggest that the Positive-rated firms have been drawing in new cash at a faster clip than those rated Neutral or Negative. For this analysis, Morningstar sorted firms into three groups based on total fund net assets to separate the industry's large, medium-size, and small firms. For this exercise, large firms are those with assets greater than $10 billion; medium firms have between $1 billion and $10 billion in fund assets; and small firms have less than $1 billion in their funds. Morningstar grouped the firms by size, as well as Parent rating, because it's easier for smaller firms to post large growth rates than it is for larger, more-mature companies with huge asset bases.

Exhibit 24 Morningstar Fund Flows for Rated Parents by Size

Firm Size and Parent Rating	3-Year Flow Billions USD	3-Year Flow Growth Rate %	5-Year Flow Billions USD	5-Year Flow Growth Rate %	10-Year Flow Billions USD	10-Year Flow Growth Rate %	Firm Count
Large Positive	13.13	8	31.16	27	72.71	89	19
Large Neutral	3.61	8	8.24	31	3.59	48	32
Large Negative	-0.17	–2	0.63	2	–6.76	–2	5
Medium Positive	1.44	13	3.00	62	5.51	205	25
Medium Neutral	1.98	26	3.27	133	5.25	146	28
Medium Negative	0.98	–7	2.13	3	6.50	249	8
Small Positive	0.61	67	1.60	331	2.21	1770	32
Small Neutral	1.23	358	1.58	495	2.44	4196	22
Small Negative	-0.02	–2	-0.27	–20	0.28	320	3

Source: Morningstar, Inc. as of 12/31/2013

Morningstar's fund-flow data show that smaller firms rated Positive or Neutral are attracting new assets at a higher growth rate than Negative-rated firms of similar size over many time periods, though that trend seems to be more significantly pronounced among the industry's largest firms. For example, Large Positive firms attracted new investments at a higher rate over the five- and 10-year periods than did several peer groups. (For the three-year period, Large Positive and Neutral parents both grew 8% per year, while Large Negative firms were in net outflows, shrinking by 1%.) Over the longest 10-year period, the differences in growth were quite stark: The 19 Large Positive firms, which include big asset winners like DFA, First Eagle, PIMCO, and Vanguard, have grown 89%, on average, while the 32 Large Neutral firms grew 48%, on average, and the Negative peers saw slight net outflows.

It cannot simply be concluded from these data that large firms with good stewardship are well-poised to grow assets. Recent performance in particular also plays an important role. Some excellent stewards of capital, including Davis Funds, saw sizable redemptions over the 10-year period overall, primarily because of a stretch of poor investment performance. The same is true for Longleaf Partners.

Among the medium-size firms, there's less of a relationship between higher Parent ratings and higher growth rates due to fund flows. To be sure, the Positive and Neutral firms have higher growth rates than the Negative firms for the three- and five-year periods, but that is not true for the 10-year period, when the Negative-rated firms' growth outpaced both the Positive and Neutral parents' growth.

The data for small firms, which understandably have the fastest growth rates, show that the Positive and Neutral parents' growth rates are higher than the Negative-rated parents, but there are very few small firms that have earned Negative Parent ratings, so it's impossible to draw solid conclusions from such a small sample size. Small firms that show evidence of being poor stewards of capital are unlikely to earn Morningstar qualitative coverage at all.

Firm-Level Data by Morningstar Stewardship Grades

The previous section focuses on data trends among firms receiving Morningstar's Parent ratings of Positive, Neutral, or Negative. Morningstar offers a more in-depth analysis of firms' care of capital through its Stewardship Grades, which analysts assign to the top 20 asset managers as measured by total mutual fund assets under management. The Parent rating and Stewardship Grade are based on the same methodology, considering Corporate Culture, Fund Board Quality, Manager Incentives, Fees, and Regulatory History. But the Stewardship Grade and Stewardship Reports delve into the details of the five components that make up the overall grade, whereas the Parent ratings feature an overall rating and summary.

The firm-level data by companies earning Stewardship Grades provide additional insight into the fund industry's mega-firms, which as a group have been more successful than their smaller peers (as illustrated on Page 15 of this study). The data show interesting differences between the firms earning A, B, and C grades.

Exhibit 25 Morningstar Firm-Level Data for Stewardship Grade Firms

Firm Name	Morningstar Stewardship Grade	Firm Average Longest Manager Tenure Years: Equal-Weighted	Firm Average Longest Manager Tenure Years: Asset-Weighted	Morningstar Five-Year Manager-Retention Rate %	Firm Fund Assets with High Manager Ownership of Fund Shares %	Average Morningstar Fee Level Distribution Percentile Rank
American Funds	A	12.0	21.6	95.62	97	18
Dodge & Cox	A	23.4	25.6	97.51	100	12
T. Rowe Price	A	7.3	11.1	95.01	21	37
Vanguard	A	6.8	11.7	91.45	16	4
Average for A Stewards		**12.4**	**17.5**	**94.90**	**59**	**18**
Dimensional Fund Advisors	B	7.4	9.9	94.73	0	7
Fidelity Investments	B	4.8	8.5	91.13	51	33
Franklin Templeton Investments	B	14.3	23.7	95.62	62	33
Invesco	B	7.3	10.2	84.06	58	46
MFS	B	8.7	10.9	94.04	41	47
PIMCO	B	5.5	15.5	91.90	48	48
Average for B Stewards		**8.0**	**13.1**	**91.91**	**43**	**36**
American Century Investments	C	7.3	10.5	92.12	0	53
BlackRock	C	4.9	12.3	86.15	65	47
Columbia	C	6.5	9.1	84.02	35	50
Janus	C	5.6	6.9	92.42	64	35
John Hancock	C	5.7	6.6	90.93	16	55
JPMorgan	C	6.9	10.5	93.86	56	34
Lord Abbett	C	7.0	10.6	87.85	55	34
OppenheimerFunds	C	6.4	9.4	87.64	64	40
Principal	C	6.8	7.9	88.38	0	52
Wells Fargo Advantage	C	7.9	9.3	91.81	20	49
Average for C Stewards		**6.5**	**9.3**	**89.52**	**38**	**45**

Source: Morningstar, Inc. Data as of 12/31/2013; Stewardship Grades as of 1/31/2014.

To be sure, these are very small peer groups—only four firms earn A Stewardship Grades, for example—but they collectively represent more than two thirds of the industry's assets. Firms with A Stewardship Grades have longer-tenured managers, higher longer-term manager-retention rates, higher manager ownership of fund shares, and lower fees. They also have been more successful, as measured by the Morningstar Success Ratios and Morningstar Risk-Adjusted Success Ratios.

Exhibit 26 Morningstar Success Ratios for Firms With Morningstar Stewardship Grades Firms

		Morningstar Success Ratio			Morningstar Risk-Adjusted Success Ratio		
Firm Name	Morningstar Stewardship Grade	3-Year	5-Year	10-Year	3-Year	5-Year	10-Year
American Funds	A	62	60	62	62	64	67
Dodge & Cox	A	100	100	100	100	100	100
T. Rowe Price	A	78	82	82	76	83	82
Vanguard	A	75	61	78	79	65	78
Average for A Stewards		**79**	**76**	**81**	**79**	**78**	**82**
Dimensional Fund Advisors	B	61	77	81	59	63	65
Fidelity Investments	B	48	57	40	40	49	32
Franklin Templeton Investments	B	42	41	45	41	42	44
Invesco	B	24	23	24	23	26	27
MFS	B	57	60	40	56	58	41
PIMCO	B	50	60	61	47	60	56
Average for B Stewards		**47**	**53**	**49**	**44**	**50**	**44**
American Century Investments	C	51	23	31	47	25	31
BlackRock	C	38	31	25	30	28	23
Columbia	C	28	21	18	24	18	16
Janus	C	49	25	45	48	27	47
John Hancock	C	41	35	20	39	34	16
JPMorgan	C	56	46	36	47	44	34
Lord Abbett	C	41	44	43	37	41	39
OppenheimerFunds	C	40	49	30	41	46	31
Principal	C	53	35	33	54	38	35
Wells Fargo Advantage	C	48	39	30	41	38	28
Average for C Stewards		**45**	**35**	**31**	**41**	**34**	**30**

Source: Morningstar, Inc. Data as of 12/31/2013; Stewardship Grades as of 1/31/2014.

Interestingly, there are marked differences in the investment approaches and business strategies of the four A firms. Each of those firms, however, have had stable lineups and have not had to merge away many—if any—trendy funds that failed to attract investors or perform competitively, an attribute that helps the firms' success ratios by limiting the size of the denominator.

Vanguard, which is mutually owned and offers its funds at cost to investors, charges rock-bottom fees that help bring the peer group's average down. What's more, the firm's lineup of funds is largely passive, and indexed funds have outperformed actively managed funds in recent years, which is a boost to the success ratios. The firm's actively managed funds have also been winners.

Dodge & Cox, a smaller firm in terms of investment offerings and staff, is notable for its long manager tenure and high manager ownership, lifting the peer-group averages. Its success ratios are uniformly high, even though its slim lineup of concentrated value-leaning offerings suffered horrible losses in 2008's market crash.

T. Rowe Price, a broadly diverse active-management firm, has less-competitive data relative to the other A firms when it comes to manager tenure, manager ownership of fund shares, and fees, but relative to the industry, it's still very strong. The firm mentors its portfolio managers well, and its manager-ownership data has dropped as the firm has moved its own retirement plan to collective investment trusts rather than mutual funds.

American Funds has suffered the worst performance of the four firms from a success-ratio standpoint, but it still beats the typical firm earning a B or C Stewardship Grade—especially over the longer term. Its value-leaning strategies have been out of style, but its firm-level stewardship data remain compelling, especially asset-weighted manager tenure and manager ownership of fund shares.

The six firms receiving B Stewardship Grades exceed the industry's standard for care of capital. All have comprehensive lineups of funds that span asset classes, though PIMCO is primarily known for its fixed-income strategies. All have notable strengths, but a few weaknesses that surface in the data prevent them from receiving Stewardship Grades of A. For example, Dimensional Fund Advisors has no manager with more than $1 million invested in a single strategy, though managers at the firm are named to multiple offerings and their combined ownership—and exposure to the firm's enhanced-index strategies—may exceed $1 million. DFA looks much stronger when it comes to fees, landing in the industry's lowest decile for firm-level fee average.

Fidelity's manager-tenure numbers are the weakest among the B stewards, which is a symptom of some of the performance challenges at the firm's equity funds and its tendency over the years to rotate managers through its funds. Its offerings, however, are competitively priced, and manager ownership of fund shares has been improving.

Franklin Templeton is a firm known for its stable management ranks, which is reflected in its high asset-weighted manager-tenure figure and five-year manager-retention rate. Meanwhile, its managers are investing at the industry's highest level to a greater extent than the other firms earning B grades for stewardship. There's room for improvement when it comes to performance: Less than half of the firm's lineup has survived and outperformed its peers, including the risk-adjusted test.

Invesco's performance looks even worse than Franklin Templeton's, but its longer-term success ratios are affected by the firm's 2010 merger with Van Kampen. After the two firms joined, Invesco merged away dozens of offerings, keeping the best strategy when two overlapped. This process benefited fundholders overall, and the resulting fees across the firm are fair but not rock-bottom.

MFS has produced some strong performance across its lineup in recent years, especially over the five-year period, which now excludes 2008's market crash (though the firm performed relatively well in 2008 overall). The firm's manager-tenure numbers are not as strong as those at Franklin Templeton or at some of the A stewards, but the firm grows its own management talent. MFS' firmwide data would be helped if those skippers invested as robustly in their funds as some top competitors.

As of Jan. 31, the final firm earning a B is PIMCO. It has launched several new funds in recent years as the firm has branched away from its core bond funds and into equities and multiasset strategies. Such moves can depress a firm's equal-weighted manager-tenure figure, but the firm's asset-weighted manager-tenure average reflects the importance (in terms of size) of flagship PIMCO Total Return and that strategy's long-tenured lead manager, Bill Gross. (Morningstar lowered PIMCO's Stewardship Grade on March 18 to a C from a B primarily because of senior-level departures at the firm.)

Half of the industry's largest firms get C Stewardship Grades. Morningstar maintains that, overall, these firms care for fundholders' capital at the industry standard. While there may be pockets of relative strength within these firms' funds, the Stewardship Grade measures the fundholder experience across the firm's funds. On average, the firm-level data at the C stewards are worse than those of the firms earning A and B grades, though in some cases, like the average five-year manager-retention rate, the differences between these small peer groups can be quite slim.

From an overall success perspective, however, the C stewards have lower Morningstar Success Ratios. None of the C stewards have longer-term Morningstar Success Ratios of 50% or higher, meaning fewer than half of their funds both survived and outperformed relative to category peers on a straight-performance or risk-adjusted basis. Some of the C firms, including BlackRock, Columbia, and Wells Fargo Advantage, have been through significant corporate mergers during the 10-year period, which can have an impact on the firms' success ratios. The ratios represent a firm's total share classes at the start of the period—the denominator—and the number that have both survived and outperformed at the end of the period—the numerator. Firms that merge funds away are at a disadvantage because they have fewer share classes at the end of the period, which drags the ratio down regardless of how well the surviving share classes performed.

Stewardship Grade Components

For firms earning Morningstar Stewardship Grades, Morningstar discloses not only the overall Stewardship Grade, but the grades for the underlying components: Corporate Culture, Fund Board Quality, Manager Incentives, Fees, and Regulatory History.

Exhibit 27 Morningstar Stewardship Grades and Component Grades

Firm Name	Stewardship	Corporate Culture	Board Quality	Manager Incentives	Fees	Regulatory History	Stewardship Grade
American Funds	A	A	C	A	A	Neutral	7/22/13
Dodge & Cox	A	A	A	A	A	Neutral	10/12/12
T. Rowe Price	A	A	A	B	B	Neutral	12/31/13
Vanguard	A	A	A	C	A	Neutral	4/22/13
Dimensional Fund Advisors	B	B	A	C	A	Neutral	1/31/14
Fidelity Investments	B	C	B	B	B	Neutral	10/21/13
Franklin Templeton Investments	B	B	B	B	B	Neutral	12/24/13
Invesco	B	C	A	B	C	Neutral	8/8/13
MFS	B	B	A	C	C	Neutral	12/23/13
PIMCO	B	B	C	B	C	Neutral	11/24/12
American Century Investments	C	C	C	D	C	Neutral	4/19/12
BlackRock	C	C	B	C	C	Neutral	4/22/13
Columbia	C	C	B	D	C	Neutral	11/8/12
Janus	C	D	A	B	B	Neutral	7/31/13
John Hancock	C	B	C	F	C	Neutral	12/5/12
JPMorgan	C	C	B	C	B	Neutral	12/23/13
Lord Abbett	C	C	C	B	B	Neutral	1/6/14
OppenheimerFunds	C	C	B	D	C	Neutral	3/28/13
Principal	C	C	C	D	C	Neutral	12/23/13
Wells Fargo Advantage	C	C	C	D	C	Neutral	3/1/13

Source: Morningstar, Inc. Data as of 1/31/2014.

In determining the overall grade, Corporate Culture carries the most weight and is assessed using a combination of qualitative and quantitative components. Some of the quantitative metrics have been discussed above. Qualitatively, Morningstar's analysts assess Corporate Culture by observing the firm's business practices to determine whether its foremost interest is gathering capital or serving fundholders. The analysts review business goals, marketing practices, compensation incentives, recent fund launches and closures, and transparency to fundholders. Morningstar also evaluates the firm's collective investment processes to determine whether they are well-supported, repeatable, and risk-aware. Evidence of manager succession planning is important, especially for firms with significant key-person risk. Morningstar makes regular on-site due-diligence visits and conducts frequent telephone interviews to help with its qualitative assessment of corporate culture.

Exhibit 27 illustrates that there is a strong relationship between a firm's Corporate Culture grade and its overall Stewardship Grade. Only four of the 20 firms graded have a Corporate

Culture grade that's different from the overall Stewardship Grade, and in cases where the grades are inconsistent, there is just one letter grade difference between the Corporate Culture grade and the overall Stewardship Grade.

For three of the four firms with dissonant Corporate Culture grades—Fidelity Investments, Invesco, and Janus—Morningstar has concluded that the firms' cultures are weaker than the firms' overall stewardship practices. Fidelity and Invesco have industry-standard cultures but earn B's for overall Stewardship Grades because they have relatively higher scores in areas such as Fund Board Quality. Janus' Corporate Culture grade is D because the firm is facing uncertainty, with departures in 2013 of some experienced managers, an arrival of a new chief investment officer, and significant outflows.

In the case of John Hancock—the fourth firm with a Corporate Culture grade inconsistent with its overall Stewardship Grade—Morningstar views the firm's culture to be relatively strong because it has moved to hire strong, experienced subadvisors to run its funds. That strategy, however, comes at a cost in terms of fund expenses (reflected in the firm's Fees grade of C) as well as less alignment when it comes to managers' own financial incentives.

The second area of the Stewardship Grade methodology is Fund Board Quality, an assessment of the directors who oversee a firm's mutual funds, whether that's one board or multiple boards. Historically, Morningstar's assessment of fund boards had some strict quantitative components, but beginning in 2011, the methodology shifted to be primarily qualitative. Morningstar's evaluation considers how well fund boards have served the mutual fund shareholders they represent at the bargaining table with the advisor. Morningstar analysts routinely interview fund board directors at firms earning full Stewardship Grades, as well as those earning Parent ratings, to determine the board's role in reviewing fund performance, negotiating expense ratios, signing off on new funds, closing capacity-constrained funds, and supporting the firm's investment processes.

Some boards admittedly have an easier governance job than others. It is difficult to find fault with the results at firms such as DFA, Dodge & Cox, T. Rowe Price, and Vanguard, all of which have well-established investment processes backing successful, low-cost funds. This strong combination of factors may not be primarily driven by the fund board, but the governance is indeed strong.

In other cases, boards have demonstrated strong leadership in areas where the directors weren't following the firm's lead, but clearly acting in the interests of mutual fund shareholders. At MFS, for example, the board has negotiated a firmwide fee breakpoint, so all fundholders benefit as new cash flows to the firm's funds—even if a specific fund wasn't the immediate beneficiary of those flows. The Invesco fund board demonstrated strong leadership during the merger with Van Kampen, thoughtfully weeding out weaker funds and pushing for lower fees. And amid years of organizational turmoil at Janus, the fund board has gone beyond its mandate to mentor the firm's investment professionals.

Among the boards with weaker grades, there's often a correlation between the Fund Board Quality grade and the Fees grade. This isn't surprising given that negotiating fees on behalf of fundholders is one of the board's chief responsibilities each year. As part of Morningstar's assessment of boards, analysts consider the number of share classes that earn a Morningstar Fee Level—Distribution score of High and hold directors accountable for such outliers. Analysts also look for unusual fee structures. This is a factor driving the C grade for the board overseeing Lord Abbett's funds, several of which have 35-basis-point 12b-1 fees rather than the 25-basis-point industry standard, though Lord Abbett is phasing out those higher 12b-1 fees.

The third component of the Stewardship Grade—Manager Incentives—looks at how well a firm's fund managers have their own financial incentives aligned with fundholders'. Specifically, Morningstar looks at the percentage of firm fund assets run by managers with at least $1 million invested alongside fundholders. Morningstar analysts do look beyond the data, however, in cases where managers may demonstrate skin in the game in other ways. At Vanguard, for example, top-tier manager ownership is relatively rare, but the managers have incentives to drive down costs, which in turn drives down fees for investors as Vanguard's fund expense ratios reflect their cost of operations. At DFA, managers are named across multiple funds that use similar strategies. None has $1 million invested in a single strategy, but several have larger investments across several funds they run, demonstrating their conviction in the firm's methodology.

To arrive at a firm's Fees grade, Morningstar looks at the firm's Morningstar Fee Level—Distribution, which is a straight average of the Morningstar Fee Level—Distribution percentile for each share class the firm offers. Firms with firm-level Morningstar Fee Level in the lowest quintile earn an A for Fees within the Stewardship Grade. The grades descend with each subsequent quintile, so firms with an average Morningstar Fee Level—Distribution higher than the 80th percentile earn an F.

With fees, it's worth noting that all of the top-20 asset managers get passing grades when it comes to fees, meaning they offer very competitive to fair prices on funds relative to those with similar strategies sold through similar channels. This suggests that fundholders are benefiting from the firms' size and economies of scale. Even so, there are meaningful differences in cost—actual and relative—between low-fee firms, such as American Funds, Dodge & Cox, DFA, and Vanguard, and the 10 firms earning C grades for Fees, which generally hug the peer groups' medians.

The final component of the Stewardship Grade methodology is Regulatory History, where firms may earn either a Neutral or Negative grade. The highest score for this section is Neutral, given to firms that have not had a significant regulatory violation in at least five years. Firms that have had run-ins with regulators earn Negative ratings until Morningstar's qualitative assessment suggests that further violations are unlikely because of improvements to the firm's compliance efforts. Morningstar also analyzes the firm's reaction to the regulatory violation, particularly how it communicates with fundholders and treats their capital. In some cases, it has taken Morningstar several years of observing newer compliance efforts and corporate policies before moving a firm's Regulatory History mark back to Neutral. As of Jan. 31, 2014, all of the firms earning Stewardship Grades earn a Neutral for Regulatory History.

Stewardship Grades and Fund Flows

Morningstar's data suggest that there is a relationship between strong stewardship metrics and better performance, but there does not appear to be a tie between good stewardship practices and fund flows.

Exhibit 28 Morningstar Stewardship Grades by Fund Flow

Firm Name	Morningstar Stewardship Grade	3-Year Flow Billions USD	3-Year Flow Growth Rate %	5-Year Flow Billions USD	5-Year Growth Rate %	10-Year Flow Billions UDS	10-Year Growth Rate %	Total Fund Net Assets as of 12/2013 Billions USD	Total Fund Net Assets as of 12/2003 Billions USD
American Funds	A	–162.20	–17	–23.45	–32	58.92	12	1,086.39	484.98
Dodge & Cox	A	–15.81	–13	–17.34	–20	41.89	86	149.09	48.98
T. Rowe Price	A	33.26	13	60.19	41	117.28	109	407.82	107.21
Vanguard	A	204.72	16	348.67	44	595.52	101	1,895.70	590.61
Averages for A Stewards		**14.99**	**0**	**92.02**	**8**	**203.40**	**77**		
Dimensional Fund Advisors	B	51.14	40	67.14	97	121.01	443	213.44	27.31
Fidelity Investments	B	–12.00	–1	27.36	5	37.29	6	1,143.82	593.61
Franklin Templeton Investments	B	27.19	8	67.40	32	90.20	47	427.18	190.98
Invesco	B	–2.43	–2	–15.91	–18	–74.32	–53	141.54	140.74
MFS	B	34.55	42	44.67	88	16.97	22	149.62	76.74
PIMCO	B	60.28	14	202.47	97	264.98	211	530.92	125.29
Averages for B Stewards		**26.46**	**17**	**65.52**	**50**	**76.02**	**113**		
American Century Investments	C	–1.04	–1	4.71	10	–19.86	–28	96.37	71.82
BlackRock	C	24.29	18	48.64	62	51.53	73	187.94	71.01
Columbia	C	–36.88	–23	–48.83	–41	–78.07	–49	163.95	159.12
Janus	C	–26.57	–25	–23.03	–37	–54.32	–56	100.44	96.58
John Hancock	C	17.59	27	22.30	54	52.70	284	100.60	18.53
JPMorgan	C	63.11	52	110.11	206	106.61	177	217.31	60.33
Lord Abbett	C	23.47	36	37.84	107	34.92	88	104.09	39.64
OppenheimerFunds	C	21.46	15	23.34	25	43.53	48	190.49	90.05
Principal	C	18.64	31	24.84	70	45.96	299	99.07	15.39
Wells Fargo Advantage	C	5.21	7	15.57	35	–16.27	–23	100.13	70.50
Averages of C Stewards		**10.93**	**14**	**21.55**	**49**	**16.67**	**81**		

Source: Morningstar, Inc. Data as of 12/31/2013; Stewardship Grades as of 1/31/2014.

Among the four firms earning A grades, for example, half have endured serious outflows over the past five years, with American Funds having lost nearly a third of its assets over the past five years, and value shop Dodge & Cox having shrunk by 20% because of outflows. Meanwhile, the other two A firms, T. Rowe Price and Vanguard, have won new assets, most impressively at Vanguard, which has more than doubled its mutual fund asset base to $1.0 trillion over the past 10 years to hold the title of largest U.S. fund manager. Vanguard and DFA have benefited tremendously by a move toward passive investing.

The other big growers include PIMCO, which drew in considerable fixed-income assets over the past decade. Several other firms, including John Hancock, J.P. Morgan, and Principal, posted triple-digit growth rates off of relatively small asset bases.

Five of the firms earning Stewardship Grades have been in net outflows over the decade, with two firms—Invesco and Janus—posting growth rates of negative 53% and negative 56%, respectively. Both have had performance problems in key strategies, and Janus' difficulties led to departures of several managers, a handful of which now work for a newer firm nearby. Columbia and Wells Fargo, also in net outflows over the 2003-13 period, both went through big parent-company mergers in the wake of 2008's market crash. Columbia merged with Ameriprise, while Wells Fargo bought out Wachovia, leading to a merger of the Wells Fargo Advantage and Evergreen funds.

The flows data suggest that investors place a higher value on shorter-term performance than they do on asset managers' stewardship practices, but such a view may be short-sighted. As we have discussed at length, stronger stewards of capital have produced stronger results, as measured by survivorship and outperformance, including on a risk-adjusted basis. Going forward, investors may be better served by placing more importance on firm's stewardship practices when choosing investments. Such a practice has tipped results in investors' favor.