MarketWatch

No skin in the game

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With most funds, managers have none of their own funds at stake

BOSTON (MarketWatch) -- In times like these, investors would like to take some comfort that they are investing like the pros. Indeed, it's comforting to know that the people running your mutual fund have their money -- and their family's cash -- mixed into the same pool as yours.

Alas, all too often it's not and the fund managers don't have enough belief in what they are doing to actually live by it.

That's the conclusion to be drawn from a new Morningstar Inc. study which looks at how much managers invest in their own funds. The data has been available for a few years now, stuffed into fund documents that no ordinary shareholder reads -- part of a Securities & Exchange Commission reform that was supposed to make funds more transparent.

All named managers for a fund must make the disclosure, putting their investment into groupings that run for $0 to over $1 million. Morningstar examined the ownership status for all of the Morningstar 500 funds; when accounting for additional share classes -- where a fund can trade under multiple ticker symbols, and sometimes with different managers, to reflect a different cost structure -- the study looked at about 6,000 issues.

In 46% of the domestic stock funds surveyed, the manager hadn't invested a dime. Other asset classes were far worse with nearly 60% of foreign stock funds reporting no manager ownership, two-thirds of taxable bond funds having no managers with money in the fund, up to 70% of balanced funds having no manager cash and some 78% of muni bond funds having shareholder cash only.

Ouch. That's a lot of managers who are going out to eat, rather than eating their own cooking.

There are some times when it makes sense for a manager to invest little or nothing. I know a few 30-something fund managers whose personal portfolio would be out of kilter if they had to throw a lot of money into the bond fund they run or the target-maturity date fund they oversee for investors in their 60s and 70s. And a single-state muni-bond-fund manager working and living outside the state has a very good excuse for investing elsewhere.

And it's understandable that managers in focused, niche funds might want to diversify and not go whole hog into their own volatile specialty; still, if they believe in the product, an investment of no cents makes no sense, especially when the lowest level for disclosure is $1 to $10,000, meaning managers can get credit for 10 grand by simply dropping a buck in their own funds.

If the manager won't bite ...

Russel Kinnel, director of mutual fund research for Morningstar, said he believes there's a direct correlation between investing in a fund and performance.

Kinnel pointed out that in Morningstar's fund analysts' "picks," the average investment by managers was $370,000, compared with $54,000 for the average analysts' "pan." Get rid of single-state muni funds and target-date funds in the picks category and the average investment tops half a million dollars.

"Is it an accident that managers are reluctant to invest in the pans, which suffer from some combination of high costs, poor strategy, shaky management, and disappointing stewardship?" Kinnel asked in a column detailing the results of the study. "The median picks have an average of $239,000 and $247,000 invested by each manager. Conversely, the median pan has $0 invested."

Fund companies can fix this problem pretty easily: Give managers their annual bonus in shares of the fund and encourage them to ride along with the clients and customers. When managers have their money in the fund -- and you can find out in the statement of additional information produced by your fund and available on request, or you can call the fund's phone reps to simply ask for the data -- they will be more sensitive to ups and downs, tax concerns and more. Clearly, the guys with millions in their own fund are acutely aware of when their performance is lagging, and must act in ways to convince themselves that they can make it pay to stick around.

Kinnel said in an interview that manager ownership stakes would not be the first thing to look at in deciding which funds to buy, "but it's a pretty good indicator of which companies are into stewardship more than salesmanship. ... If you're wavering on a fund right now, wondering if you should stick around, and you check and find out that the management is not suffering right along with you, I think you have good reason to be concerned. Those managers are collecting their paycheck, but have decided they are better off investing it somewhere else ... and maybe you'd be better off doing that too."

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