

FE fundinfo Crown Fund Ratings



**CROWN FUND
RATING** 
Powered by FE fundinfo

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Summary

FE fundinfo Crown Fund Ratings enable investors to distinguish between funds that are strongly outperforming their benchmark, and those that are not.

The top 10% of funds will be awarded five Crowns, the next 15% receiving four Crowns, and each of the remaining three quartiles will be given three, two and one Crown(s) respectively.

Rebalanced twice a year in January and July, the rating considers three key measurements to derive a fund's performance: Alpha, consistency, and volatility. Crown Fund Ratings are frequently used by professional advisers to screen for the best performing funds in a sector, and at a factsheet level are used as part of an adviser's paper trail to show thorough and rigorous research has been undertaken.

Your Questions Answered

What are FE fundinfo Crown Fund Ratings?

FE fundinfo Crown Fund Ratings are quantitative ratings, on a scale of one to five, designed to help investors identify funds which have displayed superior performance in terms of stockpicking, consistency and risk control.

A Crown Fund Rating of one reflects the lowest tier and suggests the fund has failed to impress on the above terms, while a five Crown Fund Rating reflects the highest tier.

What do FE fundinfo Crown Fund Ratings aim to achieve?

The rating identifies funds that have, over recent times, displayed superior performance in terms of:

- stockpicking
- consistency of outperformance against a credible benchmark
- achievement of results at a relatively low risk.

The rating methodology does not simply identify the best performers. Funds can achieve good performance as a result of:

- making significant bets on market movements
- sudden bursts of performance, with other periods being indifferent or poor
- taking very high risks



Our view is that certain types of performance are more valuable than others. The drivers behind performance recognised by an FE fundinfo Crown Fund Rating are those that we believe are intrinsically more valuable to investors in nature, because of their solidity.

Crown Fund Ratings are not individual fund recommendations, and should not be seen as specific advice, but as a quantitative rating to assist in refining and monitoring a list of funds suitable for consideration.

Due to the focus on Alpha, Crown Fund Ratings are aimed at the active investor. Tracker-type funds are rated using our Passive Crown Rating Methodology (see the guide for that rating for more information).

Which funds qualify for FE fundinfo Crown Fund Ratings?

FE fundinfo Crown Fund Ratings apply to all the main FE fundinfo universes including unit trusts and OEICs, investment trusts, life funds, pension funds and offshore funds.

How often are FE fundinfo Crown Fund Ratings updated?

Twice a year during January and July.

How are FE fundinfo Crown Fund Ratings calculated?

We build up a score based on analysing a fund's performance over the last three years. The score is made up of the three key components – see the methodology section below for full details.

Previously, we have used a fund's sector average as the basis of calculating these numbers. From October 2011, we have enhanced the ratings to use more closely-targeted benchmarks where sectors are too diverse, improving the quality of the calculations and removing dependence on the nature and size of fund sectors.

How broad are each of the five tiers?

Broadly speaking, the top scoring 10% of funds in each main asset class will get a five FE fundinfo Crown Fund Rating, the next 15% four Crowns, and each of the remaining 25% tiers will get three, two, and one Crown respectively.



Methodology

FE fundinfo Crown Fund Ratings are calculated by building up a score. The score is made up of three parts, and each part is calculated by reference to a credible benchmark for the fund. The calculations only have meaning if the benchmark provides a good basis for understanding the performance of that fund.

Step one – finding a benchmark

FE fundinfo has used approximately 300 well-known benchmarks, including sector averages and indices, to find a 'best-fit' for each fund.

Where sectors are homogenous and not too diverse, we have retained use of the sector average as a benchmark for all funds. However, for more diverse sectors a best-fit, appropriate benchmark is assigned.

This best-fit is compared to the best-fit two years ago, to assess the persistency of the fit, and rules are applied to resolve any lack of consistency.

No fund can be expected to have a 100% correlation to its benchmark. We use the r-squared coefficient to determine how much of a fund's performance is explained by the benchmark.

We use the r-squared value to determine the weighting of the Alpha component in our performance calculation. The remaining uncorrelated performance is calculated using the Sortino ratio, which has no requirement for a benchmark. For a fund with a perfect correlation to its benchmark the result is the Alpha value, and for a fund with a zero correlation the result is the Sortino ratio.

Results in-between are done on a sliding scale based on their r-squared correlation value. The appropriateness of a fund's benchmark will be reviewed every two years.

If it then seems that a change is appropriate, the persistency rules will still apply, to minimise changes arising from small shifts in different benchmarks' r-squared.

Step two – Analysing Alpha, volatility and consistency

Once the benchmark has been assigned, FE fundinfo then applies three tests to the total return history of the fund. Note that three years of history are required to carry out these scores, so any fund with less history than this will not qualify for a rating.

- **The Alpha test**



We calculate the Alpha generated over the last three years, and then adjust this for the volatility of the fund. We thus make the Alpha of funds comparable irrespective of differences in volatility, which can inflate the Alpha value. A score is assigned on this basis.

As perfect correlation to a benchmark is not possible in most cases, we use the Sortino ratio to calculate the remaining uncorrelated performance. Sortino measures the return to “bad” volatility without need of a benchmark. This allows a measurement of the risk-adjusted returns to be made.

NB - In the case of risk-targeted funds, only the Sortino ratio is considered. The Alpha test is not appropriate for risk-targeted funds.

- **The volatility test**

We compare the volatility of the fund over the last three years with that of the chosen benchmark and assign a score.

- **The consistency test**

We look at the extent to which a fund consistently manages to outperform its benchmark, over successive quarterly periods over the last three years. This is also scored, giving us three numbers to work with.

- **Calculating the final score**

Funds are grouped into eleven sub-asset classes, and for each of the tests, the raw scores are spread out in an array from zero (worst) to 100 (best).

The rescaled scores are set in proportion to the position of a fund’s raw score, in relation to the highest and lowest raw scores, so there tends to be a clustering in the middle with distinctive under-and over-performers.

For each fund the rescaled results for each test are then added together.

Note that for extremely low volatility funds where minuscule volatility can seem proportionately large –such as money market, gilts, and index linked gilts – the volatility component is ignored.



Step 3 – Assigning an FE fundinfo Crown Fund Rating

Within each grouping, funds are assigned ratings based on their total scores, according to the following distribution:

- the top 10% - five Crowns
- the next 15% - four Crowns
- the next 25% - three Crowns
- the next 25% - two Crowns
- the bottom 25% - one Crown

Exclusions

Funds which fit the criteria below are excluded for technical reasons:

- funds with short history.
- is a passive fund tracking an index.
- The fund has no fixed style.
- The sector is too small to be rated.

The following sectors are also excluded:

- Unclassified (unless the fund is included in FE fundinfo' s Risk-Targeted Universe).
- Personal pensions.
- Protected funds and structured products.
- Direct physical property funds.

The protected and structured product category is the most sizeable, due to the recent launch of numerous products. These are not suited to a FE fundinfo Crown Fund Rating.

Other considerations:

FE fundinfo Crown Fund Ratings are purely quantitative and backward looking, and, as such, cannot offer any certainty about the future.

In order to get a fully rounded view, an investor should also consider:



- Qualitative measurements and comments, which look at the quality of the processes by which a fund is managed.
- The strength and track record of the fund manager(s) involved in running the fund.
- The strength and approach of the asset management group behind the fund in the field in which that fund operates.

