

## Fund Ratings

FDD uses several sources of data in assembling its list of First Class Funds. Some are based on past returns (quantitative), some on the company, people and processes involved (qualitative) and some a mixture of the two.

### Morningstar Qualitative Research

Morningstar evaluates funds based on five key pillars, which its analysts believe to be predictive of future performance. Analysts judge each pillar, as well as the entire fund, against peers.

People - assesses the quality of a fund's managerial team

Parent - assesses the quality of the investment firm

Process - evaluates the investment strategy and its execution

Performance - looks at previous returns

Price - analyses the relationship between fund expenses and future performance

Analysts assign a Morningstar Qualitative Rating™ to funds using a five-point scale ranging from Elite to Impaired. Analysts rate funds on a relative basis, against a pan-European and Asian universe of funds in a similar peer group.

Elite: represent analysts' highest conviction picks.

Superior: above average and capable of producing peer-beating returns.

Standard: not standouts, but nor are they deeply flawed.

Inferior: thought to be deficient relative to their peers in key respects.

Impaired: a severe structural defect make these offerings extremely poor investments.

Under Review: reassessment following a fundamental change. This is not a rating.

The ratings reflect Morningstar analysts' conviction in the fund's ability to outperform over the long term.

### Morningstar OBSR Fund Ratings

OBSR provides fund ratings as an independent mark of quality. Based on a research process where qualitative research is supported by quantitative analysis, the ratings are evidence that they believe a fund is, for its type, consistently producing the returns it set out to deliver, and is likely to continue to meet its investment objectives over the long-term.

Following a due diligence process and categorisation, a fund may then be considered for an OBSR fund rating. The backbone of the process is qualitative research, based on regular, face-to-face meetings with fund managers. There are a number of key areas always covered:

Group ownership and stability - is the group committed and adequately resourced

Investment philosophy – are objectives realistic and clearly understood

Personnel – the quality of the manager and supporting team

Investment process – is it understood and applied effectively and consistently

Research resources – the quality of internal and external research

Portfolio construction and risk controls – attitude to risk and its monitoring

Funds are then presented to the OBSR fund rating committee for consideration. OBSR currently rates about 250 out of a universe of approximately 3000 funds. The ratings used are Gold, Silver and Bronze, being differentiated by the strength of conviction of the analyst that the fund will outperform its benchmark over time, within the context of the level of risk taken. The ratings are designed to be an independent mark of quality but also a clear indication of their conviction in a manager's ability to meet or exceed a fund's objectives compared to other funds of a similar type.

A review programme exists for every fund to assess whether the investment process is still in line with their previous understanding and is appropriate for its objectives. Following these review meetings, they consider whether the OBSR fund rating is still appropriate. Should a material change occur between regular reviews, this is considered and where appropriate the OBSR fund rating may be adjusted, suspended or removed.

### Square Mile Fund Ratings

Square Mile is an independent investment consulting and research business, established in 2014, that works in partnership with financial advisers, wealth managers, investment platforms and life companies, to provide tailored investment services.

Square Mile's Academy of Funds provides a platform for some of the greatest talent in the UK retail investment industry. Encompassing only the "best-in-class" funds that we are prepared to recommend to our clients, the Academy of Funds champions quality, clarity, and consistency. Every fund that achieves a place in the Academy of Funds is the subject of exhaustive qualitative research and analysis.

Both quantitative and qualitative analysis is used, the latter considering:-

People – analysts and managers

Philosophy – clear ideas of what the fund should do

Process – well defined to produce outcomes in line with the philosophy

Objective – needs to be realistic and able to be understood by investors

Portfolio Construction – diversified but with appropriate risk controls

Performance – consistent with the objectives

Cost – in line with objectives and portfolio construction

Funds are given ratings according to the confidence of the analyst that they will meet their objectives from AAA to A

### Lipper Ratings

Lipper provides a quantitative analysis of fund performance for several criteria. The ones that FDD use are as follows:-

**Total Return** - Lipper Ratings for Total Return reflect funds' historical total return performance, measured in local currency, relative to peers as defined by Lipper.

**Consistent Return** - Lipper Ratings for Consistent Return reflect funds' historical risk-adjusted returns, measured in local currency, relative to peers.

**Capital Preservation** - Lipper Ratings for Preservation reflect funds' historical loss avoidance, measured in local currency, relative to peers.

For each of the ratings the highest 20% of funds in each classification are named Lipper Leaders, the next 20% receive a rating of 4, the middle 20% are rated 3, the next 20% are rated 2, and the lowest 20% are rated 1.

### FE Crown Ratings

The FE crown ratings are a quantitative-based ratings system designed to highlight funds that have had superior consistent performance in relation to risk, relative to their peer groups. Peer groups are deemed to be the sectors as defined by the IMA, unless the sector is deemed too diverse, when more targeted benchmarks are employed.

All rated funds get a crown rating, one crown being the lowest rating, and five crowns being the highest. No crowns means the fund has not been rated.

Funds are not rated for the following reasons -

- fund is less than 3 years old
- sector is not meaningful for comparison purposes - e.g. the Specialist sector
- sector has had too few members over 3 years to be significant

The rating is made up of three constituents

**Alpha** relative to the sector, measured over 3 years but with a higher weighting given to the more recent rather than the more distant past

**Volatility**, measured over 3 years but with a higher weighting given to the more recent rather than the more distant past

**Consistency**, based on a fund's performance ranking within its sector in each quarter of the last 3 years. Each quarter is weighted equally

Within each sector,

- top 10% of funds in each main asset class will get five Crowns
- the next 15% four Crowns
- next 25% three Crowns
- next 25% two Crowns
- final 25% one Crown