

Morningstar FundInvestor's Annual "Unloved Funds" Study Proves Contrarian Investing Can Work – It Pays to Rally Behind Wall Street's Rejected Funds

Chicago, IL - (Jan 16, 2002) - Morningstar, Inc. today, released its annual "Unloved Funds" study, which identifies the three least-popular mutual fund categories from the previous year, as measured by asset outflows. The study can be found in the January issue of *Morningstar® FundInvestor™*, a monthly newsletter for individual investors.

Morningstar has found that investing in the three unpopular categories from a given year and holding on for three years has been a profitable strategy for investors who have the courage to swim against the tide. Funds from unpopular categories have beaten the average equity fund during the next three years more than 70 percent of the time. Moreover, unpopular funds have outpaced popular ones more than 90 percent of the time.

"The Unloved Funds study isn't about performance," Gabriel Presler, fund analyst for Morningstar, said. "We're measuring how funds are affected by fund flows during the past year. The study shows that contrarian investing can work, though we understand that it takes bravery and a willingness to wade into ugly situations."

Morningstar offers concrete reasons why funds from the following "unloved" categories have scared investors:

- Communications – Many of these specialty funds focus on the hard-hit telecommunications-equipment area, which has continued to be dogged by inventory gluts and spending reductions. The average communications fund lost well over a third of its value in 2001, and the category's assets dwindled by 17 percent.
- Latin America – Although Latin America funds fared better than most foreign funds in 2001, investors' optimism for the region slipped last year as Argentina fell further into debt and trouble with the World Bank.
- Diversified Pacific/Asia – These funds, which invest in Japan and elsewhere in Asia, continue to be plagued by losses in Japan and concern about the region's aborted structural reforms. Owing to their wretched returns, diversified Asia funds were among the least-popular fund types last year.

"These funds may look worthy of being unloved, but we're betting on change," Presler said. "If the past is any indication of the future, these groups are likely to outpace the current market darlings – the mid-cap value, small-cap value and small-blend categories – over the next three years."

Although the unpopular categories vary widely each year, the process never changes. Morningstar suggests investors heed the following if they want to put the findings from its "Unloved Funds" study to work in their portfolios:

Buy one fund from each of the three unpopular groups.

Not every downtrodden category will rally during the next three years, so a small stake in each group can make the difference. As an example: In 1997, investors who followed this strategy bought a diversified Pacific/Asia fund, a Pacific/Asia ex-Japan fund, and a communications fund. Despite two Asian meltdowns in 1998 and 2000, the unpopular group posted a three-year annualized return of 9.1 percent – nearly double the return of the popular group – thanks to the communication category's performance.

Limit the investment.

Unpopular categories often dabble in highly volatile markets, so an investor's exposure to these funds should not account for more than 5 percent of a portfolio. Mishaps have happened in the past: In 1995, Morningstar suggested investors buy funds in the communications, precious-metals, and European-stock categories. Because of a terrible showing from the precious-metals funds, the unpopular group posted a three-year annualized return of only 10 percent – half the gain of the popular funds.

If possible, buy soon.

Morningstar studies have shown that, generally, investors can buy the funds up to a year later and the strategy still works. However, all three unpopular categories for 2001 are vulnerable to market-timers; when they swoop in, the stocks can head up in a hurry. In this case, it's best to buy early while stock prices are still low.

Invest new money.

Put new money, such as a raise or a bonus, toward this investing strategy. If that isn't possible, investors should consider scaling back on stakes in popular fund offerings.

The "Unpopular Funds" study is published in the January issue of *Morningstar*® *FundInvestor*TM, the company's monthly mutual fund publication. To subscribe, call 1-800-735-0700.

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