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Advisor Perspectives' Study Reports that Morningstar Ratings Fail Over a Full Market Cycle

Morningstar's "Star" ratings of mutual funds fail to predict performance over both up and down market cycles

LEXINGTON, MA – December 9, 2009 – One of the most widely used guidelines for mutual fund selection is Morningstar's system of 1- to 5-star ratings. According to a recently released study by Advisor Perspectives, for the three years ending September 30, 2009, the Morningstar system failed to predict the future performance of the funds it rated.

The Advisor Perspectives' study evaluated the predictive ability of the rating system by calculating the probability that a randomly selected fund with a given rating at the beginning of the three-year period would outperform a randomly selected fund with a different rating.

One of the common decisions a financial advisor makes is whether to move to a fund with a rating one star higher – for example, to move from a 4-star to a 5-star fund. Across the Morningstar universe, the probability such a move would result in selecting a higher performing fund was only slightly better than 50%. In a number of categories, 5-star funds turned out to be the worst performing funds. "Advisors might as well flip a coin to decide whether a fund rated one star higher is any better than the one they already own," said Bob Huebscher, CEO, Advisor Perspectives.

Advisor Perspectives conducted a similar study in 2007, when it measured the effectiveness of the rating system from 2004-2006, a time period that was almost entirely a bull market, and found the ratings offered predictive ability. The 2009 study, however, encompasses the bear market of 2008 and the bull market of 2009, and therefore represents the full cycle of market conditions that investors should anticipate when purchasing a fund.

"Morningstar's methodology is based on trailing three, five and ten-year performance. Our results confirm that this methodology based on past performance does not offer any meaningful insights into future performance," said Huebscher,

Advisor Perspectives publishes a weekly electronic newsletter that is distributed to more than 80,000 financial advisors, with a focus on actionable advice and insightful analysis. Advisor Perspectives' content is designed to provide advisors with specific strategies and tactics to serve their clients better and to create a competitive advantage for their practice.

To view a full copy of the study, click [here](#).

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