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FUND TRACK

Mutual Funds Change Monikers, But Not Holdings, to Woo Money

Portfolios Adopting New Names Attract
More Investors Than Those That Don't

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As if chasing past returns wasn't risky enough, it turns out mutual-fund investors are also plenty willing to chase pretty-sounding names.

A new academic study shows that funds can attract investors in droves simply by adding trendy words to their monikers -- even such mundane labels as "large," suggesting that a fund might invest in large-company stocks.

The academic research highlights the degree to which fund investors are susceptible to the marketing stratagems used by fund companies, which stand to boost their own profits by increasing the assets in their funds.

Indeed, funds that change their names were found to attract 22% more new money than funds of similar size, investment style and other features that don't undergo a name makeover. And that is true even if the name changes are purely cosmetic, without significant change in the way the fund invests.

"It's like saying by suddenly changing your name, you're a better fund," says P. Raghavendra Rau, a management professor at Purdue University in West Lafayette, Ind., who co-wrote the paper. That is obviously not a rational conclusion. "If I call myself Brad Pitt, for example, it shouldn't make me more attractive to women," Prof. Rau says.

Critics say mutual-fund companies sometimes make marketing moves that play to investors' emotions but end up costing them money. As Internet stocks soared in the late 1990s, for instance, many companies rolled out specialized Internet funds and other new technology funds that ended up being among the biggest losers when the bubble burst.

In recent years, academics have been zeroing in on just what it is that induces investors to turn over their money to a particular fund and the degree to which those factors actually help -- or hurt -- the investors' fortunes. Here is some of what they have found.

WHAT'S IN A NAME?

Family Business

When a mutual-fund family can boast funds ranking in the top 5% of all funds, investors send in the cash -- but to all of the family's offerings, not just to the top-performing funds, according to "[Family Values and the Star Phenomenon](#)³," a working paper from finance professors Vikram Nanda and Lu Zheng and PhD. candidate Z. Jay Wang, all of the University of Michigan. They also find that fund companies spreading their bets across many investment styles underperform those that concentrate on just a few styles.

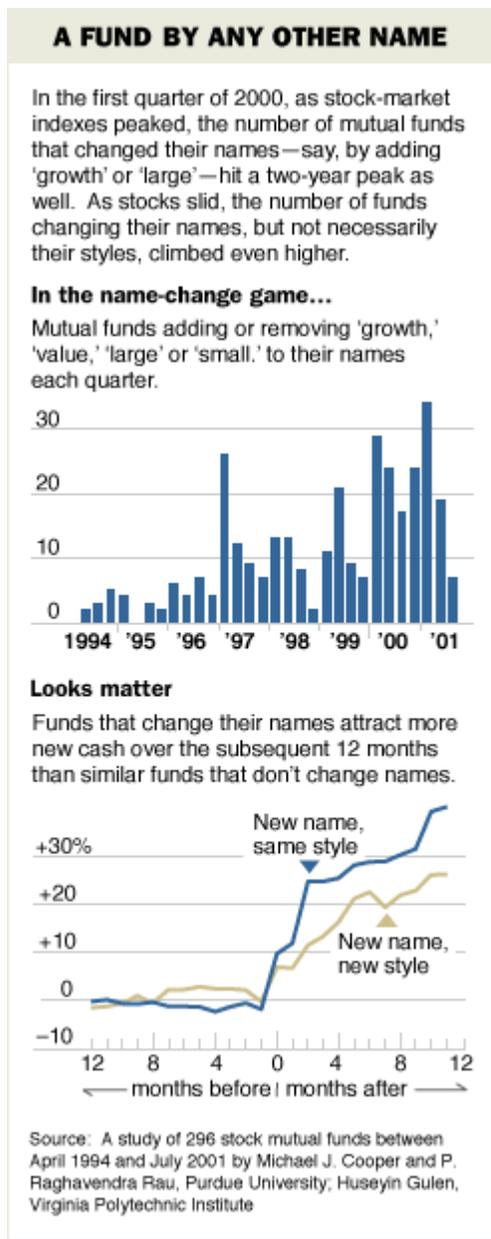


Name Game

Adding a "hot" label to a mutual-fund's name draws substantial new cash from investors, even if the fund doesn't change its investing style, according to "[Changing Names with Style: Mutual fund name changes and their effect on cash flows](#)⁴," a working paper from Purdue University management professors Michael J. Cooper and P. Raghavendra Rau and Virginia Tech finance professor Huseyin Gulen.

What's in a Name

It is taken as a truism in financial circles that investors will flood funds or investment categories that have performed well in the preceding months or even years. Technology funds, for example, drew \$4.1 billion in new money in the six months after the Nasdaq Composite Index peaked in March 2000.



But according to the study by Prof. Rau and two other academics -- Michael J. Cooper, also of Purdue, and Huseyin Gulen of Virginia Polytechnic Institute -- investors also will pump money into funds that simply sound like they belong in a hot category. Just adding "growth" to a fund's name when fast-expanding growth stocks are outperforming discounted value stocks often would do the trick, they found.

Funds amending their names reaped an average of \$67 million more than similar funds over the course of the next 12 months following the name change, with funds hewing to hot trends getting most of the gain, the study found. On average, the funds studied each had assets of \$299 million, so the new money amounted to a significant increase in the funds' coffers. All told, during the seven years from 1994 through 2001, 296 funds raked in some \$19.9 billion in additional money that could be attributed to name changes, the paper says.

For example, the \$9.5 million **AIM Small Cap Equity Fund** changed its name to the AIM Small Cap Growth Fund in September 1998; over the next year, the fund drew in \$189 million in new investment, though it is unclear how much can be attributed to the name change. AIM notes that the fund had recently been acquired and was renamed to reflect a new growth-oriented style, just as that style caught on and began attracting investors. "We don't change a name to stimulate growth of assets," a spokesman said.

Strikingly, the researchers found that it made little difference whether funds actually changed their investment strategies to match their name changes. In fact, what did make a difference was how much funds raised their so-called 12(b)1 fees, which are largely

devoted to marketing spending, and how much they levy in one-time sales charges, or loads. The more these expenses rise, the more new money the funds making name changes were likely to attract, according to the study.

Style and Substance

Of course, fund-industry officials have known for a long time that the choice of names can sway investors' fund selections. Over the years, some funds had altered their names without altering

their portfolios (or kept their names as is while altering their portfolios) to the point that fund names and the securities in their portfolios sometimes bore little resemblance to one other.

So in 2001, the Securities and Exchange Commission adopted regulations requiring many funds to invest at least 80% of their assets in the type of securities their names suggest, up from the previously required 65%. More than 2,000 fund share-classes changed names in 2002, excluding changes that were the result of mergers, according to Morningstar Inc.

The study by the professors at Purdue and Virginia Tech in Blacksburg, Va., isn't the first to show that investors are attracted to funds that advertise more heavily or that are promoted by commission-paid brokers and financial advisers. But often, the true cause and effect is fuzzy, says Erik R. Sirri, an associate professor of finance at Babson College in Wellesley, Mass.

For one thing, fund companies tend to advertise their most successful funds by touting glowing investment returns. That leaves open the question of whether investors flock to funds that are advertised heavily, or to funds that perform well, because they tend to be the same funds, according to Prof. Sirri.

Prof. Rau says he and his colleagues have shed some light on that question because the name-changing funds tracked in their study weren't the top performers. Indeed, in most respects they were average -- except that investors were withdrawing money from them up until the name change. Until that point, "They have really lousy fund flows compared to other funds," Prof. Rau says. "It seems to me they are doing this to take advantage of hot styles and cold styles."

Investors can look beyond fund names to examine actual portfolio holdings with the help of investment-tracking services available at such Web sites as Morningstar.com (www.morningstar.com¹).

All in the Family

Not only can a hot fund attract piles of money from investors, but fund companies sponsoring top-performing portfolios also draw money to other offerings in their fund lineup that have mediocre performance, according to research co-written by researchers Vikram Nanada, Z. Jay Wang and Lu Zheng at the University of Michigan in Ann Arbor. In a working paper, "Fund Families and the Star Phenomenon," they looked at money flowing in to individual funds at families sponsored funds with top performance numbers.

The researchers suspect that advertising is the link. "If you have a star fund in the family, it helps to attract money to other funds as well," says Prof. Zheng. "By running those ads, they somehow enhance the brand name of the whole family, so other funds benefit."

Unfortunately, spreading your money among both a family's star fund and its less stellar siblings on balance delivers only average returns. "If we invest in star families, do we do better than average? The answer is no," Prof. Zheng says. As a group, the funds of families boasting star funds don't perform any better than the funds of other fund families.

On the other hand, investing across the board in the "star" families "doesn't hurt [investors] much either; performance is just about average," Prof. Zheng adds.

But before investors go chasing after the hot fund category du jour, they should know that going

with the flow of new cash can be hazardous, says Russ Wermers, a business professor at the University of Maryland, which is based in College Park.

Specifically, attracting a lot of money probably isn't a good thing for those already invested in an actively managed fund -- until that money is put to work, it drags on the fund's performance in a rising market, Prof. Wermers says. "When a manager gets hot and does well, these flows come in and push [the manager] out of the market for a while, and that hurts performance temporarily."

Indeed, some research suggests that this "drag" accounts for much of the gap between the performance of actively managed funds and index funds, Prof. Wermers adds.

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JANUS SHARE SHUFFLE: Shares in money-management firm **Janus Capital Group** rallied after the company announced its executives and portfolio managers had converted their shares in the company's major subsidiary to shares in the parent company.

The Denver company's shares were up \$1.09, or 11%, at \$10.95 in 4 p.m. New York Stock Exchange composite trading, after the firm, which used to be known as Stilwell Financial Inc., said the transfer of shares would be "modestly accretive" to diluted earnings this year.

The transaction resulted in private shares of subsidiary Janus Capital Management LLC converting to approximately 15.7 million shares of the parent company, or 7.5% of the shares outstanding. The step will help diluted earnings by lowering the company's effective tax rate. Janus shares fell earlier in the week after the company reported assets under management fell 2.9% in February to \$132 billion, larger than drops in major market indexes. The company said the retreat was due to market depreciation and outflows in institutional money markets.

-- Yuka Hayashi

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