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Best Funds – Greater Risk but Greater Returns

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Most investors recognize that stocks provide greater rates of return than bonds. Most also acknowledge that greater risk is attendant to greater returns. This relationship also holds true for the relationship between small stocks and big stocks; small stocks return more than big stocks because risks associated with small stocks are greater.

The biggest battle on risk and return is often fought between the value and growth fund camps. The value camp maintains that value funds are less risky and provide higher rates of return than the growth approach. However, this does not reconcile well with Capital Asset Pricing Theory which specifies a strong correlation between risk and return. The higher the risk, the higher the return - the lower the risk, the lower the return.

For example, the little-known Wiesenberger Mutual Fund Indexes show that during 1958-2004 a $100 investment in growth funds grew to $9,380 and the same $100 investment in value funds grew to a lesser $7,046. Underscoring further the relationship between risk and return, the riskiest Wiesenberger asset class of aggressive growth funds produced a 1954 ending value of $14,152.

Until 1998 only five or so mutual funds had achieved a triple-digit return of 100% or more in any year. In 1998, seven funds achieved this milestone and in 1999 an astounding 177 funds broke through the triple-digit threshold. Every one of these funds was a growth fund or sector fund; not a single one was a value fund.

A look at Table 1 showing the Top Ten performing mutual funds during 1987-2001 intimates a high-risk profile for each fund. Risks associated with these funds include high P/E, high beta and low diversification.

Table 1 - Top 10 Mutual Funds during 1987-2001

Rank	Fund	Annualized Return
1	Fidelity Select Electronics	21.2%
2	Vanguard Health Care	20.8
3	Seligman Communication	19.7
4	Fidelity Select Software	19.4
5	Eaton Vance World Health	18.8
6	Fidelity Select Biotech	18.6
7	Fidelity Select Health Care	18.4
8	FPA Capital	18.3
9	Invesco Health Sciences	18.1
10	Invesco Leisure Inv	16.2
	S & P 500 Index	13.7

Source: Money Magazine

In looking at the Top 10 Funds nearly 15 years later reveals that Capital Asset Pricing Theory still holds sway as shown in Table 2.

Table 2 - Top 10 Mutual Funds during 2006-2015

Rank	Fund	Annualized Return
1	ProFunds Biotechnology	15.4%
2	Rowe Price Health Sciences	14.6
3	Rydex NASDAQ 100 2x Strategy	13.8
4	ProFunds Ultra NASDAQ 100	13.7
5	Rowe Price Global Technology	13.3
6	Fidelity Select Retailing	13.2
7	Fidelity Select Software	13.1
8	ProFunds Internet Sector	12.9
9	Rowe Price Media & Telecom	12.7

Source: InvestorPlace, 3/10/16

Once again, high risk health and technology funds were dominant among the top funds. In the most recent tabulation, two very high risk(leveraged) OTC 100 stock index funds made it into the Top 10. Above results are in sync with Capital Asset Pricing Theory.

The best performing funds will almost always be found in the riskier investment categories - not in every year or two, but over the long term. The very best funds will often be concentrated in one industry or sector and will tend to be less diversified than the typical fund. In sum, assuming greater risk can lead to greater rewards in the stock market.