Specialty Funds vs. General Mutual Funds and Socially Responsible Investment (SRI) Funds: An Intriguing Risk/Return Paradigm

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This paper examines the benefits and detriments of specialty funds (sector funds) during both bull and bear markets. We created a contrasting analysis between general global mutual funds, specialty funds and Socially Responsible Investment (SRI) funds, incorporating 1 year, 3 year, 5 year and 10 years annualized returns for fifteen popular funds (period ending 5/7/2010), and found that specialty funds exhibited superior risk/return tradeoffs.

HISTORY OF SPECIALTY FUNDS

Specialty funds are commonly referred to as sector funds. Sector funds have been and always will be an important segment of the mutual fund industry. Some investors even believe that specialty funds may be the superior business for the mutual fund industry because they charge higher expenses and loads than diversified stock funds. This allows them to generate a greater percentage of the mutual fund revenues. Specialty funds should only be used by investors who believe they can select a sector at the right time or investors who want to be in a particular sector without buying individual stock.

Specialty funds are a type of mutual fund that focuses their equity investing within a specific industry or sector of the economy. Some specialty funds cover broad sectors and others direct their investments on an industry group within a sector. The most common sectors include: energy, financial services, health care, precious metals, real estate, technology, and utilities. To be classified as a specialty fund, a fund must invest at least 25 percent of its portfolio into one sector, although the majority of specialty funds invest all of their holdings into a single sector or industry. Specialty funds can be unstable investment vehicles, especially when viewed in isolation. This is why most investors utilize the portfolio approach when investing in specialty funds. Stock prices of companies within a sector or industry move in direct correlation with one another due to casual factors. Some examples of casual factors would be: changes in government policies and regulations, introduction of new technologies or products, business cycle dynamics, shifts in the consumer demand or demographic, transformation of the industry's structure, or even international events. A specialty fund's return is dependent on the impact of the sector's casual

factors. These casual factors that drive the specialty fund's returns consequently lead to the specialty fund's level of risk.

Many specialty funds are 'no-load' funds, which means they do not levy a sales charge. Some mutual fund companies have implemented a short-term redemption fee, incase the investor holds the specialty fund shares for less than a determined minimum period. This discourages short-term trading while protecting the interests of long-term shareholders. Practical investors use specialty funds in ways that "leverage their return potential while managing portfolio volatility. Sector funds can also be used to construct diversified portfolios, enhance returns of diversified portfolios, and stabilize diversified portfolios for consistent profits" (Subramanian).

There is limited evidence on the performance of specialty fund managers in the academic finance literature. The primary roots of specialty funds date back to 1981, when Boston-based Fidelity Investments commenced offering them. Around 1985, the flashy performance of some sector funds had caught the attention of many individual investors. In the mid 1980s, "specialty funds were firmly lodged in the top spots of the mutual fund rankings. For example, of the 860 mutual funds whose performances were monitored by Lipper Analytical Services, specialty funds filled the top four spots for the 12-month period ending on August 22, 1985. The top performer was Prudential-Bache Utilities, with a rise of 50.8 percent. Next were Fidelity Select Financial (up 45.4 percent), Fidelity Select Leisure (42.7 percent), and Century Shares Trust, which specializes in insurance companies (39.6 percent). In fact, of the top 10 performers, 7 were specialty funds" (Springer).

However, these attractive gains of specialty funds in the mid 1980s only reveal half of the story. "Specialty funds turned in some of the poorest performances as well. Gold funds lost 17.1 percent on average and many technology funds recorded significant losses in the same 12-month period. At the same time, the Standard & Poor's 500 index rose by 12.1 percent, excluding reinvested dividends" (Springer). Timing is a key element in the equation of specialty funds. Timing is essential to avoid being trapped in a sector that is decaying. Market trends are constantly changing and shifting, which causes different sectors to become more favorable at certain times. Specialty funds in a broad sector can even be difficult to evaluate in regards to timing. Specialty funds have a historical track-record of being consistently inconsistent.

EMERGING TRENDS OF SPECIALTY FUNDS

In evaluating the current and emerging trends of specialty funds, there is no evidence supporting the claim that specialty fund investors can select the winning funds within a specialty fund category. The performance of a specialty fund that is not rationalized by changes in factor returns can be justified by chance rather than the investment picking skills of the fund's manager. Specialty funds "neither outperform nor underperform the relevant benchmarks. There is no persistence in specialty fund returns. Specialty fund investors usually do not have the ability to pick the winning funds or the winning sectors. This is all consistent with market efficiency" (Tiwari). On average, specialty funds charge annual expenses of 1.65 percent. The difference in fees and expenses cannot be explained by the variations in the specialty fund size or turnover. "Specialty funds also charge higher loads in the form of rear-end fees. It is not obvious that the higher loads and expenses of a specialty fund arise from higher operating costs" (Tiwari).

Fees and expenses are higher among specialty funds that focus on a particular industry. These specialty funds are more costly to monitor and manage. Figure 1 shows how there are significant variations between funds and their respective expense ratios. These higher expenses are partially due to the fact that the cost of information for evaluating specialty is greater than the cost of information for typical stock funds. It becomes an issue of the degree of information asymmetry between insiders and outsiders.

FIGURE 1
EXPENSE RATIOS FOR SELECTED INVESTMENT OBJECTIVES*
Year End 2009

Investment objective	10th Percentile	Median	90th Percentile	Average *Asset-weighted*	Average *Simple*
Equity Funds	**0.82**	**1.44**	**2.28**	**0.87**	**1.52**
Aggressive growth	0.91	1.49	2.33	1.03	1.58
Growth	0.78	1.33	2.16	0.91	1.43
Sector funds	0.92	1.62	2.50	0.98	1.70
Growth and income	.052	1.21	2.00	0.56	1.25
Income equity	0.75	1.24	1.98	0.85	1.32
International equity	0.99	1.60	2.45	1.02	1.67
Hybrid funds	**0.63**	**1.20**	**2.00**	**0.84**	**1.28**
Bond funds	**0.52**	**0.96**	**1.73**	**0.65**	**1.08**
Taxable bond	0.50	0.99	1.80	0.65	1.09
Municipal bond	0.55	0.92	1.62	0.64	1.07
Money market funds	**0.22**	**0.50**	**.091**	**0.34**	**0.54**

*Figures exclude mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.
Sources: Investment Company Institute and Lipper

There is a new emerging trend in specialty funds. Due to the vast variation in returns of specific industries, investors have identified the need to invest in the right sector at the right time in order to capture the potential return. Sector rotation is an investment method in which the investor seeks to increase returns by strategically switching from one industry to another. Theoretically, this process will assist specialty fund investors in attempting to exceed the returns generated by buy-and-hold investors. Timely sector rotation increases the value of investment accounts and portfolios. Discreet sector rotation offers significant potential to grow wealth over time. "For example, major corporations recently pruned technology related capital spending, whereas falling interest rates kept consumer spending strong. To profit from such secular trends, an investor may choose to invest in Fidelity funds such as '*Select Consumer Industries*' (NASDAQ: FSCPX) and '*Select Leisure*' (NASDAQ: FDLSX) while avoiding '*Select Technology*' (NASDAQ: FSPTX)" (Subramanian).

To employ the sector rotation strategy, investors need to understand and follow the dynamics of each industry. Investors must be able to make informed decisions on which industries to enter and which industries to avoid. Through sector rotation, specialty funds have the potential to outperform the market averages on the foundation of relative returns and risk-adjusted returns. The key word to recognize and remember when entertaining the thought of utilizing specialty funds and sector rotation is 'potential'. There is also the potential to lose a substantial amount of money. The word 'consistency' does not describe specialty funds. There is a great amount of perceived risk involved with specialty funds. For most people, the level of this perceived risk is simply too high when dealing with investing for retirement plans.

COMPARISON OF RISKS AND RETURNS

It is important to evaluate risk and return when comparing mutual funds to specialty funds. Usually with specialty funds, the potential return on the investment does not off-set the present risk at hand for the investor. "Besides having a lot in a single stock, a sizable weighting in a single sector runs big risks because sometimes everything in an industry goes in the tank at the same time" (Morningstar). On that same note, an industry can greatly exceed expectations during a bull market. Specialty funds vary widely in volatility; it depends on the diversity and volatility of the industry's businesses as well as the strength

of the correlation between the stock prices of the companies included in the portfolio. There are many high risk tactics associated with specialty fund investing. One high risk strategy is to trade sector funds for short-term returns by taking advantage of opportunities created periodically by market volatility.

When evaluating industries and sectors for specialty funds, it is important to understand that each industry is going to possess a different level of risk and return. Each industry is unique in its own aspects. "Sectors like energy, for example, often move with little correlation to the overall stock market. Exposure to such sectors can therefore help dampen portfolio volatility" (Subramanian). You can expect President Obama's Health Care Reform to have an impact on the healthcare industry; it is too early to determine whether or not it will benefit or weaken the investing in the health care industry sector.

On the positive side, the higher risks associated with specialty funds have the possibility to lead to incredible returns. Specialty funds are typically very aggressive with their investing; this can result in big returns or great losses. The unpredictable performance of specialty funds places them at the top or bottom of the mutual fund performance rankings. "A hot fund's portfolio typically balloons because of big cash inflows from investors eager to climb on the bandwagon. The fund must lower its investment criteria for the companies within its sector to accommodate that new money, making it challenging to continue to beat the market" (Springer).

Although mutual funds are not as risky as specialty funds in general, there is still some risk present for those investors. One of the main points to keep in mind when determining the risk associated with mutual funds is the fact that mutual funds are not guaranteed or backed by the FDIC. This immediately puts mutual funds at a higher level of risk. Mutual funds carry multiple types of risk: concentration, sector, price, business, market, credit, interest-rate, liquidity, emerging-markets, and currency.

"Funds with a high percentage of assets in their top holdings are not necessarily riskier than other funds, but they can be. Some take on a lot of individual stock risk. When a stock is trading for a high valuation, disappointing news will generally spur much larger losses than one with a low valuation. At the heart of every stock fund is the risk that the businesses of the stocks they own will deteriorate. A fund with losses can slip into a downward spiral if its holdings are so illiquid that its losses spur redemptions and then the redemptions spur more losses because the fund manager has to sell securities at fire-sale prices, as the cycle gains steam. Emerging markets have outsized returns and outsized losses because they are based on rickety economies that work well in some environments but can fall apart in others" (Morningstar). Corporate bonds and emerging-markets-government bonds possess the risk of defaulting. Interest rates weigh on the vulnerability of a fund being impacted by increased rates.

Mutual funds should be less risky than specialty funds, predominately due to the level of vulnerability carried by specialty funds. Specialty funds go against the old saying, "Do not put all your eggs in one basket." Mutual funds possess the quality of diversity and a more balanced level of risk. Many investors incorrectly believe that only high risk will produce great returns. However, brilliant investors such as Warren Buffet and the late John Templeton have proven that low-risk investment can create large returns. In evaluating this notion, it becomes increasingly difficult to defend the position that specialty funds are better investments than general mutual funds. The inconsistency associated with specialty funds tends to make them less attractive.

INFLUENCE OF BULL AND BEAR MARKETS

"Shareholder sentiment generally moves with stock market performance because of the impact on mutual fund returns. For example, mutual fund companies' favorability rose in the late 1990s along with stock prices (measured by the S&P 500), then declined between May 2000 and May 2003 as stock prices fell, and increased after 2003 as the stock market gained until the 2008 stock market crash (ICI – *Fact Book 2010*).

Many mutual fund companies are going to advertise and claim that they can outperform the market in both bull and bear markets. These mutual fund companies will focus on specific points in time when the data was in their favor. Companies focusing on specialty funds will comment on how "the bull market in 1999 produced a 132.4 percent gain from technology (FSPTX), which outpaced the S&P 500's 19.5

percent advance" (Subramanian). Or how "the 2002 bear market produced a 64.3 percent gain from gold (FSAGX), which topped the S&P 500's 23.4% loss" (Subramanian).

Tests have been performed that combined "Jensen's Alpha (1968) and the Fabozzi and Francis (1979) test for bull and bear market parameters by testing three different asset pricing models: the Capital Asset Pricing Model (CAPM), the Fama and French three-factor model, which adds SMB (small minus big factors to the CAPM), and the Carhart four-factor model, which adds a momentum factor. Of the Ferson and Schadt (1996) mutual funds, only 12 of the funds had positive bear market alphas using the CAPM, 14 positive bear market alphas under the Fama and French three factor model, and 12 positive bear market alphas using the Carhart model. The bull market alphas dominated the bear market alphas, However, the results were statistically insignificant according to their t-tests" (Hamidani).

These test results support the claim that markets are mutual-fund efficient and that fund managers generally cannot outperform the market, whether it is a bull or bear market. A mutual fund is going to be more vulnerable to change with a bull or bear market than a specialty fund. This is because a specialty fund has a narrow range of scope in its portfolio. Sometimes the changes in a bull or bear market will not affect the specific industry that the portfolio is invested in. A mutual fund has a much broader portfolio that expands over multiple industries and sectors, thus becoming more susceptible to the changes and shifts in the market and the flow of the stock prices. Both mutual funds and specialty funds rely on the ability of the portfolio manager to identify shifts and changes in the bull or bear market. Reaction time is limited in both cases.

INVESTMENTS IN "ETHICAL FUNDS

One particularly interesting type of specialty fund is the so-called "ethical" funds. "Ethical" funds are also called "virtue funds" or Socially Responsible Investment (SRI) funds. SRI funds invest only in "virtuous" companies such as those with environmentally friendly practices or objectives, or companies that have outwardly humanitarian upper management. SRI funds exclude companies that profit from "unethical" or "vice" products or services such as tobacco, alcohol, pornography, gambling and the like. They also exclude companies who participate in unethical practices such as child labor or poor working conditions.

For years, there has been significant debate in the financial industry about whether it is more or less lucrative to pursue an "ethical" investment strategy by investing solely in SRI funds and socially responsible companies. John Rothchild, a popular investor, called socially responsible investment "a dumb idea" in a May 1996 Fortune magazine article. On the other end of the spectrum, it has also been found that socially responsible mutual funds outperform traditional mutual funds, though slightly. (Guerard, JR.) Ultimately the choice of whether or not to invest in socially responsible funds depends on the investing style and strategy that an investor wishes to pursue. In this case the question becomes, "Is it more lucrative to invest with a sense of ethics and/or morality, or is it better (in terms of returns) to strictly follow a strategy based on other characteristics such as value, growth, or low-risk?" (Guerard, Jr.)

In general, SRI funds have been observed to have tendencies towards purchasing the stocks of companies with higher market capitalizations. In addition, SRI funds tend to be more value-oriented than growth-oriented in their investment style. (Guerard, Jr.) The expense ratios for SRI funds tend to be higher than the expense ratios for mutual funds in general. However, the loads and turnover ratios of SRI funds were found to be lower than that of general mutual funds. (Gil-Bazo) Therefore, SRI funds likely balance out with general mutual funds in regards to the costs of investment because their expenses are higher on average, but their average loads and turnover ratios are lower. Only a performance evaluation of SRI funds in comparison to other types of funds can actually provide evidence towards a conclusion for the question of the value in ethical investing.

A performance evaluation will also help to explain the one critical aspect of mutual funds that has yet to be addressed: how they react to differing market conditions. So far, the internal aspects and characteristics of general mutual funds and specialty funds have been identified and explained, and the specific differences in the investment styles of conventional mutual funds and specialty funds have been

established. All of that information is useful and helpful in selecting a fund or funds to invest in. However, the final, and perhaps most pertinent, characteristic of a fund is how it performs in varying market conditions. More specifically, it is necessary to analyze how well mutual funds and specialty funds perform in bull markets and bear markets. The best way to analyze that performance is through the statistical analysis of an array of funds or an index.

STATISTICAL ANALYSIS

To analyze the performance of mutual funds and specialty funds in differing market conditions, we have selected five general mutual funds and five specialty funds to compare and contrast. We will analyze their returns, risk values, fees, as well as their performance against the S&P 500. In addition, we selected five socially responsible funds to be analyzed. We chose the funds on the basis of size, and not return or risk, which could skew the results, but not necessarily. The fifteen funds we chose are among the largest in their respective categories in terms of net asset value. Table 1 lists the fifteen funds, and includes their ticker symbols, fund names, and net asset value as of May 7, 2010.

TABLE 1
FUND SYMBOLS, NAMES AND VVALUES AS OF MAY 7, 2010

	Ticker Symbol	Company	Net Asset Value (as of 5/7/2010)
General Mutual Funds	PTTRX	PIMCO	$128.75 Billion
	AGTHX	American Funds	$67.98 Billion
	VTSMX	Vanguard	$65.22 Billion
	FCNTX	Fidelity	$59.23 Billion
	CAIBX	American Funds	$57.63 Billion
Specialty Mutual Funds	FKTFX	Franklin	$12.93 Billion
	VGHCX	Vanguard	$11.25 Billion
	VEURX	Vanguard	$6.68 Billion
	FNMIX	Fidelity	$3.46 Billion
	FSAGX	Fidelity	$3.23 Billion
SRI Funds	PRBLX	Parnassus	$2.81 Billion
	ARGFX	Ariel	$2.31 Billion
	PAXWX	Pax World Funds	$1.86 Billion
	AMAGX	Amana	$1.72 Billion
	CAAPX	Ariel	$1.67 Billion

Data Source: http://www.marketwatch.com/investing/mutual-funds

Notice in Table 1 that the Net Asset Value of each fund type decreases as the investment becomes more specific. The general funds are a mixture of growth and value funds, and are not exclusive as to which companies or industries they invest in. The specialty funds are separated as follows:

- FKTFX invests solely in municipal bonds from the state of California
- VGHCX is Vanguard's Health Care industry fund
- VEURX is Vanguard's European investment fund
- FNMIX is a Fidelity Emerging Markets fund
- FSAGX is a Fidelity Gold (commodities) fund

Though most of the SRI funds simply screen their investments to meet basic socially responsible criteria, the fund AMAGX is a fund that bases its investments on the tenets of Islam. Table 1 simply gives a snapshot of current net asset value of each of the funds used in this analysis, but to analyze accurately, it is important to look at the average returns of each of the fifteen funds throughout different time measures. Table 2 does just that.

TABLE 2
FUND RATES OF RETURN AS OF MAY 7, 2010

RETURNS OF THE FIFTEEN FUNDS						
CATEGORY	**FUND**	**YTD**	**1 YR**	**3 YR (Annualized)**	**5 YR (Annualized)**	**10 YR (Annualized)**
General Mutual Funds	PTTRX	3.77%	13.99%	9.92%	7.43%	7.98%
	AGTHX	-2.09%	21.04%	-6.06%	2.95%	1.03%
	VTSMX	0.92%	26.97%	-7.05%	1.76%	0.09%
	FCNTX	-1.42%	24.78%	-3.58%	4.67%	3.27%
	CAIBX	-4.30%	16.23%	-607%	2.96%	7.00%
	AVERAGE	**-0.62%**	**20.62%**	**-2.57%**	**3.95%**	**3.87%**
Specialty Mutual Funds	FKTFX	4.31%	12.90%	3.68%	4.15%	5.61%
	VGHCX	-4.80%	19.79%	-3.70%	3.67%	6.70%
	VEURX	-15.65%	12.265	-14.62%	0.47%	0.85%
	FNMIX	2.42%	23.495	7.335	9.52%	11.99%
	FSAGX	5.92%	36.815	12.50%	23.99%	19.58%
	AVERAGE	**-1.565**	**21.05%**	**1.045**	**8.365**	**8.95%**
SRI Funds	PRBLX	-2.03%	25.60%	0.24%	6.02%	5.52%
	ARGFX	5.11%	47.94%	-7.29%	-.014%	8.24%
	PAXWX	-2.07%	15.31%	-5.10%	1.41%	1.94%
	AMAGX	-0.42%	23.13%	-1.00%	7.58%	3.11%
	CAAPX	2.575	45.55%	-3.54%	2.85%	8.01%
	AVERAGE	**0.635**	**31.51%**	**-3.34%**	**3.54%**	**5.36%**

Data Source: http://www.marketwatch.com/tools/mutualfunds/fundcomparison.asp

Table 2 illustrates that overall specialty funds produce the highest rates of return. It is safe to assume that the three year annualized rate represents primarily a bear market, because 2008, 2009, and some of 2010 were the recent recessionary years. Therefore, specialty funds performed the strongest of the three types with a 1.04% rate of return as compared to a negative 2.57% rate of return for the general mutual funds and a negative 3.34% rate of return for SRI funds. In addition, specialty funds performed the most robustly in both the five year and ten year categories. However, it is possible that the specialty fund sample did so well because of the substantial increase in gold prices over the past three to four years, and that its rate of return was boosted by the returns of FSAGX. To dispute this possibility is the poor performance of the Europe fund (VEURX) over that same period, which should balance out the average return. It is also interesting to note that SRI funds performed more strongly than general mutual funds in the ten year category, and handedly outpaced both general funds and specialty funds with a 31.51% rate of return in the one year category. However, SRI funds also reacted poorly to the bear market, suffering the largest decline in returns of the three for the three year return numbers.

TABLE 3
FIND RISK VALUES AS OF MAY 7, 2010

RISK VALUES OF THE FIFTEEN FUNDS				
CATEGORY	**FUND**	**Beta (β)**	**Std. Deviation (σ)**	**R-squared**
General Mutual Funds	PTTRX	0.83	1.39	0.14
	AGTHX	0.14	5.70	0.94
	VTSMX	0.09	5.95	1.00
	FCNTX	0.32	5.39	0.90
	CAIBX	-0.01	4.39	0.91
	AVERAGE	**0.52**	**6.48**	**0.49**
Specialty Mutual Funds	FKTFX	0.36	2.24	0.16
	VGHCX	0.13	4.87	0.65
	VEURX	-0.37	7.57	0.87
	FNMIX	0.94	4.50	0.58
	FSAGX	1.55	13.20	0.17
	AVERAGE	**0.52**	**6.48**	**0.49**
SRI Funds	PRBLX	0.62	5.04	0.93
	ARGFX	0.36	9.87	0.85
	PAXWX	0.05	4.27	0.90
	AMAGX	0.52	4.87	0.91
	CAAPX	0.58	8.26	0.87
	AVERAGE	**0.43**	**6.46**	**0.89**

Data Source:http://www.marketwatch.com/tools/mutualfunds/fundcomparison.asp

Table 3 shows that on average, specialty funds have the highest Beta values of all types of mutual funds, illustrating that the risks of investing in specialty funds are the most pronounced overall. Conventional mutual funds, on the other hand, have the lowest Betas of the three types of funds in the sample. This indicates that general mutual funds have the lowest volatility, meaning that they are the least sensitive to market movements (bulls and bears), whereas specialty funds have the highest volatility in returns of the three types of funds and are therefore the most sensitive to market movements. This is no surprise, and relates to the "putting all your eggs in one basket" idea. This table also indicates that all of the funds have low Betas, indicating relatively low volatility, which typically makes returns more dependable and easier to predict, though that is not always the case.

The standard deviation values for specialty funds are also the highest of the three types of funds included in the analysis, closely trailed by SRI funds. The conventional mutual funds have the lowest standard deviation values of the three. This indicates that conventional mutual funds do not deviate as much from their mean returns as specialty and SRI funds do. Once again, conventional mutual funds prove to be the least volatile, this time with respect to its rates of return in comparison to past years. Therefore, they are considered the least risky of the three types, and specialty funds are considered the most risky. This would explain why the rates of return of conventional mutual funds in Table 2 are steadier on average than the rates of return of the specialty funds. It is interesting, however, that in this sample specialty funds appear to be the most risky but still performed the most strongly in the bear market.

Finally, the R-squared values for the three categories, which measure the correlation between a fund's movements and the movements of the market, indicate that the Beta values of SRI funds and conventional funds are measured against the appropriate benchmark, whereas the Beta of specialty funds may not be. R-squared values in this case fall between 0 and 1, which means that values like 0.78 and 0.89 indicate accurate benchmarking for the Beta of their respective funds. However, the R-squared value of specialty funds is at 0.49, which indicates that the Beta of specialty funds may be measured against the wrong benchmark and may therefore be inaccurate. This may be the reason for the conflict between the high Beta of specialty funds and their corresponding high returns in the bear market. It is possible that the actual Beta is a lower value, and therefore could help explain why specialty funds still experienced positive returns despite the bear market. But there are still other factors to analyze.

TABLE 4
FUND FEE RATES AS OF MAY 7, 2010

FEE RATES OF THE FIFTEEN FUNDS					
CATEGORY	**FUND**	**Front Load**	**12b-1 Fees**	**Expense Ratio**	**Turnover Ratio**
General Mutual Funds	PTTRX	0.00%	0.00%	0.45%	300%
	AGTHX	5.75%	0.24%	0.75%	38%
	VTSMX	0.00%	0.03%	0.18%	5%
	FCNTX	0.00%	0.005	1.02%	58%
	CAIBX	5.765	0.23%	0.66%	43%
	AVERAGE	**2.30%**	**0.10%**	**0.615**	**89%**
Specialty Mutual Funds	FKTFX	4.25%	0.09%	0.57%	11%
	VGHCX	0.00%	0.02%	0.36%	6%
	VEURX	0.00%	0.045	0.27%	18%
	FNMIX	0.00%	0.00%	0.915	126%
	FSAGX	0.00%	0.00%	0.87%	42%
	AVERAGE	**0.85%**	**0.03%**	**0.60%**	**41%**
SRI Funds	PRBLX	0.00%	0.00%	0.99%	60%
	ARGFX	0.00%	0.25%	1.14%	45%
	PAXWX	0.00%	0.25%	0.98%	43%
	AMAGX	0.00%	0.25%	1.31%	6%
	CAAPX	0.00%	0.23%	1.25%	44%
	AVERAGE	**0.00%**	**0.20%**	**1.13%**	**40%**

Data Source: http://www.marketwatch.com/tools/mutualfunds/fundcomparison.asp

Table 4 is quite surprising in that it illustrates that specialty funds have the lowest expense ratios of the three types of funds. It is usually the case that the specialty funds have higher expense ratios than conventional mutual funds. The highest expense ratios belong to SRI funds, which is consistent with SRI funds throughout the market. The expense ratios of conventional mutual funds are just slightly larger than that of specialty funds at 0.61% to the specialty funds' 0.60% ratio.

CONCLUSION

Based on the information and data discussed in this paper, we have concluded that in general, specialty funds actually outperform conventional mutual funds. The statistical analysis indicates that the specialty fund category, while carrying the greatest risk, also provide the greatest returns. The risk is simply not significant enough to substantially affect the specialty funds in bear markets. It is very likely that we found the performance of specialty funds in bear markets to exceed the performance of conventional funds because the conventional funds have much higher average turnover ratios, and therefore charge expenses much more frequently. In addition, we must concede to the possibility that our results were slightly skewed in the favor of the specialty fund sample due to our inclusion of Fidelity's high performing gold commodities fund (FSAGX). However, in reviewing S&P 500 comparison charts, excluding the gold fund, we would still conclude that specialty funds slightly outperform conventional mutual funds, primarily due to their strong performance in bear markets.

Much to our dismay, we could not conclude that SRI funds are more lucrative than investment in general mutual funds. The data and statistical analysis simply did not support such a conclusion. However, it is also important to remember that other immeasurable factors influence the performance of any type of mutual fund, such as the fund's management or expectations for changes in the macroeconomic environment. It is also important to keep in mind that each investor has a different set of investment goals and therefore a different investment strategy that best suits her/him. Investors should determine what strategies best help them achieve their financial and personal goals and invest in funds that employ those strategies. Portfolio customization is the key.

We found that, specialty funds have a cyclical nature and investors who utilize them need to be committed to monitoring market conditions and the portfolio's performance. Investors need to devote the proper time and also possess the expertise to correctly manage these funds in order to avoid devastating losses.

Secondly, mutual funds adhere to the common principle of not placing all your eggs in one basket. Mutual funds provide investment portfolios with diversification, variety, daily pricing, and liquidity. Specialty funds carry a higher level of risk because the vast majority (if not all) of the holdings are placed into companies within the same industry. Casual factors cause these companies to fluctuate directly with one another. Drastic changes in casual factors can ruin an industry before managers and investors have time to react.

Finally, the costs and fees associated with mutual funds are less than the expenses linked with specialty funds. Both funds can lose their principle, but the costs associated with specialty funds can bury an investor deeper into debt. Specialty funds generally do not out-perform or under-perform mutual funds. In comparing these two funds, mutual funds are considered the stronger investment because they can generate a greater amount of return with less risk. Investments with less risk are very attractive, especially to people who are investing for their future retirement plans.

Practically speaking, when we implement a coefficient of variation analysis, and actually show a per unit of risk per unit of return analysis, we witness some interesting phenomena. Combining the risk with the return, we find that coefficients of variation from the ten year period studied, showed that specialty funds only took on .724 units of risk per unit of return, while general mutual funds produced 1.18 units of risk per return unit. SRI funds showed 1.21 units of risk per unit of return, and indicate that the ethical considerations may be important to the investor but the risk return tradeoff does not look very attractive. (See Exhibit 1)

Uncharacteristically, for the 10 year returns ending May 7, 2010, we clearly show a lower risk per return relationship for specialty funds over general mutual funds. SRI funds exhibited the highest risk per return relationship during this time period. We are not suggesting that these results would be replicated in future ten year time frames, but we certainly must conclude that once again that the risk/return relationship need not always be symmetrical.

EXHIBIT 1
DATA AS OF MAY 7, 2010

	10 Year Returns (Annualized)	Standard Deviation	Coefficient of Variation
General Mutual Funds			
PTTRX	7.98%	1.39%	0.174
AGTHX	1.03%	5.7%	5.53
VTSMX	0.09%	5.95%	66.11
FCNTX	3.27%	5.29%	1.65
CAIBX	7%	4.39%	0.63
AVERAGE	3.87%	4.56%	1.18
Specialty Funds			
FKTFX	5.61%	2.24%	.40
VGHCX	6.70%	4.87%	.73
VEURX	.85%	7.57%	8.91
FNMIX	11.99%	4.50%	.38
FSAGX	19.58%	13.20%	.67
AVERAGE	8.95%	6.48%	.72
SRI Funds			
PRBLX	5.52%	5.04%	.91
ARGFX	8.24%	9.87%	1.20
PAXWX	1.94%	4.27%	2.20
AMAGX	3.11%	4.87%	1.57
CAAPX	8.01%	8.26%	1.03
AVERAGE	5.36%	6.46%	1.21

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