17 Funds for 2017 and Beyond

Some fund ideas for long-term investors.

Fund Spy | 01-10-17 | by Russel Kinnel

With transitions in the White House, Fed policy, and the inflation outlook, it feels particularly precarious to make predictions. On the plus side, investors have enjoyed tremendous gains in recent years as equities have had one of their all-time great runs, especially in the United States. In addition, unemployment and inflation are low.

But given the cyclical nature of markets, the chances for a bear market grow the longer a rally lasts. There are signs that inflation is on the rise, and the Federal Reserve has acted accordingly. It raised rates in December and signaled it expects to raise them three more times in 2017. That doesn't mean that markets or the economy will hit the brakes, but it could signal more sobriety in the markets. The bond market has noticed the potential for even more inflation and rates are rising.

To me, the best response to uncertainty is diversification. If it's unclear where we are headed, I want my eggs in a lot of baskets. I also want to be sure that I err on the side of caution rather than aggression, but I wouldn't make the mistake of equating foreign with high risk and domestic with low risk. Diversifying by country and, to a lesser degree, currency will reduce your risk.

In fact, investment management firm GMO forecasts emerging markets will be the highest-returning markets over the next seven years. Its forecasts are after subtracting inflation, so the figures are not quite as bad as they might first sound. However, it doesn't adjust for risk. It forecasts a 4.4% real return for emerging-markets stocks and a 1.8% real return for emerging-markets debt. Emerging markets have been some of the worst-performing regions in recent years because of slowing growth from China and a decline in commodity prices. Emerging markets might actually be cheap in a world in which not much looks cheap. GMO's worst return forecasts are for U.S. large-cap stocks (negative 3.0%), U.S. small caps (negative 2.3%), international bonds hedged back to the dollar (negative 3.0%), and U.S. bonds (negative 0.8%). It's just one forecast, of course, but it's certainly sobering.

The ideas shared here are ones that are particularly appealing at this time, but they are still meant to be long-term investments rather than one-year bets. Be sure to read the complete analysis for any fund you consider so that you can figure out if it suits your needs. You can find all our Morningstar Medalists here.

So, how should you diversify? Glad you asked.

Short-Term Bond Funds

Short-term bond funds are all about playing defense. It's good to have some protection against rising interest rates and falling stock prices.

Baird Short-Term Bond (BSBIX) (or (BSBSX) for the Investor share class) is a well-run cautious fund with a Morningstar Analyst Rating of Silver. Mary Ellen Stanek leads a team of six managers who have produced consistently solid returns here without much risk. The fund owns a mix of corporates, Treasuries, and mortgages.

Silver-rated Vanguard Short-Term Investment-Grade (VFSTX) focuses on corporate bonds, which means it is a bit more vulnerable to a credit meltdown than a government fund but a little less vulnerable to a spike in interest rates. And of course it is cheap.

Gold-rated Vanguard Short-Term Inflation-Protected Securities Index (VTIPX) is a good way to get some inflation protection without much interest-rate risk. As Christine Benz points out, most Treasury Inflation-Protection Securities funds have longer duration than this one and thus are quite vulnerable to rising rates even though they protect against rising inflation. (The two are related but not identical, and there are times when one occurs and the other doesn't.) Just be sure to put this in a tax-sheltered account as TIPS are not tax-friendly.

That leads me to Gold-rated T. Rowe Price Tax-Free Short-Intermediate (PRFSX), which is tax-friendly. Maybe the most predictable outcome from Washington in 2017 is a tax cut for the wealthy, and that prediction has spurred a sell-off in muni bonds, as they are priced on an aftertax basis. I am hoping that's been priced in, and that would mean this fund would deliver steady, if modest, returns.

Foreign Equities and Bonds

If you have 80% or more of your portfolio in U.S. securities, you probably could do with some foreign exposure. Foreign developed markets are no riskier than the U.S. market, and they should reduce the overall risk of a portfolio that is heavily skewed to the U.S.

Foreign markets have the added appeal of having mostly lagged the U.S. in recent years and so may be a bit cheaper. Here are four good ways to play them.

Smaller-cap stocks have less correlation with U.S. large caps because their fates are more closely tied to their local economies. So, the small-cap-focused T. Rowe Price International Discovery (PRIDX) is a good place to start even though it's the most volatile of the funds in this bunch. Justin Thomson seeks out small companies with strong growth potential, and he's done a fine job of it in 18 years here. The fund has beaten the MSCI World ex USA Small Cap benchmark by more than 500 basis points annualized over that time period. We give the fund a Silver rating.

Causeway International Value (CIVVX) is on the other end of the Morningstar Style Box, plying a tested large-cap value strategy. The contrarian in me likes the fact that it has been out of favor the past three years but still boasts a great long-term record. Usually such funds come back with robust returns, and I have faith in Sarah Ketterer and Harry Hartford to guide the fund to better results.

Templeton Global Bond (TPINX) recently joined the No Transaction Fee club, and it merits a close look. Michael Hasenstab is an aggressive investor who isn't afraid of controversy, as evidenced by bets on Brazil and Hungary. In fact, you get quite a bit of emerging-markets exposure here because Hasenstab thinks they have better finances and stronger growth potential. I wouldn't take a huge position in this Gold-rated fund for that reason, but it does provide diversification and the potential for strong returns.

Vanguard Total International Stock Index (VTIAX) is for the investor who likes to keep things simple. Low costs, broad exposure, and little change make this an easy fund to hold. The fund charges only 0.11%, and it's tough to beat.

World Stock

World-stock funds may raise your foreign exposure only slightly, but they are a sensible way to invest. Why limit a manager's investment universe? Here are two of the best funds, and they happen to have recently become more accessible.

We recently highlighted top funds at American in light of their move to join No Transaction Fee networks, and Gold-rated American Funds Capital World Growth and Income (CWGIX) (or (CWGFX) in NTF platforms) is one of my favorites. The strategy is to find good values with decent yields, and it has done a fine job of it. As Morningstar analyst Alec Lucas points out, the least experienced of the nine managers on this fund has been in the investment industry for two decades.

Artisan Global Value (ARTGX) reopened to new investors in October 2015 after a down year led to outflows. In the first 11 months of 2016, the fund took in $425 million, so I wouldn't be surprised if it closes again in 2017. I'm a big fan of how well David Samra and Dan O'Keefe have executed a focused value strategy similar to the ones run by Oakmark (their former home). The strategy tends to create lumpy performance but strong long-term results. This fund has only endured two years of modest underperformance thanks to strong stock selection and wariness of debt.

Emerging Markets

My emerging-markets shopping list always starts with the Asian specialists at Matthews funds. They go deeper down the market-cap spectrum yet tend to run with less risk than their peers. Matthews Asian Growth & Income (MACSX) is one of our favorites. Robert Horrocks and Kenneth Lowe's pursuit of income serves to damp risk quite nicely. They look for dividend-paying stocks, convertibles, preferreds, and bonds. Although they cast a wide net, they typically own only 50-60 securities. The result has been marketlike returns with much less volatility.

Fidelity New Markets Income (FNMIX) is a steady hand in the rather dicey emerging-markets bond Morningstar Category. John Carlson and his team have delivered outstanding results through a mix of caution and aggression. They stick mostly to hard-currency bonds yet make contrarian moves into places like Brazil and Venezuela. The fund is also attractively priced at 0.84%.

Large Growth

Poor large growth. It's had yet another year of brutal outflows, and in December two former flagbearers for the style were slated for the chopping block: Janus said it would merge away Janus Twenty (JAVLX) and Janus (JANSX). With any luck, we'll get some articles about the "Death of Growth Investing" and then I'll really be sure it's time to buy. In the meantime, here are two large-growth funds to make you happy.

No, I'm not contractually obligated to include a Primecap fund in every "Where to Invest" article, but I'm going to again anyway. Primecap Odyssey Growth (POGRX) is run by some of the very best growth investors out there. Primecap has seasoned managers and analysts who make a career of working at the firm, and it shows in the results. And it charges only 0.65%.

Fidelity Contrafund (FCNTX) is another rather obvious pick because Will Danoff just keeps chugging along. In 2016, Danoff lost to both the S&P 500 and the Russell 1000 Growth Index because of some tech and financial stocks that lagged. I'm sure it just tore him up because he really takes that personally. That's why it doesn't happen often. Look for Danoff to come roaring back despite this fund's gigantic asset base.

Newly Rated Medalists

Sometimes it's better to think of opportunities in terms of securities rather than asset class. In that spirit, I thought I would share three Morningstar Medalists that we started (or restarted) covering in 2016.

T. Rowe Price Tax-Free Income (PRTAX) earned a Gold rating for delivering the complete package. Munis aren't the place people look for excitement. People who invest in muni funds want skilled investors running a dependable strategy in a low-cost vehicle, and that's what you get here. Dino Mallas avoids bets on shaky credits by and large, and he doesn't make interest-rate bets. That makes for a reliable fund.

Fidelity Mortgage Securities (FMSFX) happens to be something of a contrarian play as mortgages stalled in 2016 after a long run of strong performance. We gave the fund a Silver rating because lead manager Bill Irving has successfully taken a reasonable valuation-driven approach. Most of the fund goes into government mortgages, but a small slice of around 10% to 15% goes into asset-backed securities and commercial and residential mortgage-backed securities. Since Irving took over in 2008, the fund is ahead of its peers and benchmark.

FMI International (FMIJX) merited a Silver rating right out of the box. Lead manager Pat English and team have shown that their approach that has worked well for U.S. stocks translates nicely overseas. They look for solid businesses with a good track record of investing capital. The portfolio is concentrated in just 20–30 names, and turnover is quite low. Since its December 2010 inception, the fund is comfortably ahead of peers and benchmark. That record was aided by currency hedges as the dollar has rallied most of the time the fund has been around. I wouldn't project as much outperformance in the future as currency movement is pretty cyclical.

Target-Date Funds

Target-date funds have produced excellent investor returns in recent years, meaning investors use them well. The reason is partly because they are so boring that they don't inspire panic or greed. The other part is that they are 401(k) vehicles in which investors generally invest steadily through the markets' ups and downs. So, a simple thing you can do to achieve your goal is to invest as much as you can in your 401(k)'s target-date fund and stick to it. Vanguard's target-date lineup is one of the best.

Russel Kinnel is director of manager research for Morningstar and editor of Morningstar® FundInvestorSM, a monthly newsletter.

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