



Follow-up to Our Story on FundGrades

In response to our articles in last week's newsletter, [FundGrades: Exposing the Weaknesses in Peer Group Comparisons](#) and [Our Analysis of FundGrades](#), a number of readers asked for more detailed information on FundGrades' methodology. For those who plan to use FundGrades, we encourage you to review the information on their [web site](#). But the FundGrades team provided the two tables below, which we believe serve as a good reference guide for interpreting FundGrades' data.

The first table summarizes the methodology behind each of the five criteria in the grading system:

| | Basic FundGrades Rules* | A | B | C | D | F |
|------------------------|--|--|-----------------------------------|---|--|----------------------------|
| Diversification | Correlation coefficient to selected benchmark | >.985 | >.97 | >.94 | > =.82 | <.82 |
| Expense | Honor Roll benchmarked as lowest 10% expense ratio for each asset class, grades assigned relative to benchmark expense ratio | < 50% | <130% | <200% | < = 400% | >400% |
| Risk | Ratio of fund standard deviation to benchmark standard deviation | <85% | <99% | <105% | < = 115% | >115% |
| Return | Relationship of return relative to benchmark as measured | Return exceeds index by more than 50% of the | Return exceeds index by more than | Return within +/- 20% of the benchmark SD | Return under index by more than 20% of the | Return under index by more |



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|-------------------------|---|--------------|-------------------------|------|--------------|------------------------------|
| | by the standard deviation (SD) of the benchmark | benchmark SD | 20% of the benchmark SD | | benchmark SD | than 50% of the benchmark SD |
| Under Perf. Risk | Percentage of monthly returns fund exceeded index return less index benchmark expenses | >77% | >65% | >53% | > = 41% | < 41% |
| Overall | Simple average of other grades | | | | | |
| | *Note- FundGrades has further breakpoints between letter grades for + and – grades and the breakpoints shown here for each letter grade include funds graded + or - for each letter grade | | | | | |

The second table summarizes the distribution of grades for each criterion, as of 10/31/07:

| | A | B | C | D | F |
|--|----------|----------|----------|----------|----------|
| Overall | 0.54% | 8.28% | 41.96% | 43.93% | 5.23% |
| Diversification | 12.58% | 17.48% | 31.25% | 38.69% | *0% |
| Expense | 2.19% | 16.19% | 25.53% | 40.53% | 15.50% |
| Risk | 18.62% | 28.80% | 16.96% | 16.86% | 18.76% |
| Return | 4.35% | 11.06% | 45.95% | 26.81% | 11.83% |
| Underperf. Risk | 3.73% | 14.74% | 42.37% | 27.24% | 11.92% |
| *FundGrades only grades funds scoring > F versus any of 31 asset classes | | | | | |
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