



## **A Proven Process for Selecting Mutual Funds, ETFs and Building Investment Portfolios**

*Star ratings fade. A durable process doesn't. Here's the manager-selection framework I've refined over 40+ years.*

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### **Introduction**

Identifying truly skilled investment managers capable of outperforming their peers is a labor-intensive process that demands experience, judgment, and analytical discipline. This paper outlines a structured framework for evaluating mutual funds and exchange-traded funds (ETFs) with the goal of isolating a small number of best-in-class managers who appear capable of delivering superior long-term results. It reflects the methodology developed and implemented over many years, including during my service as Director of Manager Research at multiple investment firms.

My approach rests on a fundamental conviction: past performance alone is not predictive of future results. Instead, we combine quantitative screening with deep qualitative analysis to identify managers who possess what I believe is a sustainable competitive advantage—an identifiable "edge" that we believe can persist across multiple market cycles.

This document describes our comprehensive framework for manager selection and monitoring, built upon a foundation of alignment with investor interests.

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### **Executive Summary**

This framework combines quantitative screening with deep qualitative due diligence to identify a small number of truly skilled managers.

A proprietary Manager Selection Score (MSS) distills multiple risk, return, cost, and consistency metrics into a single, research driven ranking, focusing attention on the small subset of funds and ETFs most worthy of deeper due diligence.

Qualitative review centers on six dimensions: parent, people, process, performance, current positioning, and price.

In a global universe of tens of thousands of mutual funds and ETFs, our process systematically narrows the field to a small number of strategies that meet our high standards.

I maintain in-depth research reports on 90+ funds and ETFs that meets our high standards, and while investors who subscribe as founding members have access to the full library, selected reports are periodically featured and made available to paid subscribers as part of ongoing publication content.

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### **Who I Am**

I'm an independent investment analyst and CFA charterholder with over 40 years of experience analyzing stocks, mutual funds, ETFs, building portfolios, and helping investors navigate markets with discipline and clarity.

I previously served as Chief Market Strategist and Director of Manager Research at major firms, where I led work on fund selection, asset allocation, and investor communication. I have taught the retirement planning section of the Chartered Financial Planning designation to financial advisors at the University of Missouri-St. Louis.

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## My Philosophy

I do not believe that all active management is worthwhile. Markets are efficient in many ways, and most managers underperform their benchmarks after fees. However, I also recognize that exceptional managers do exist—professionals who possess the skill, resources, and discipline to outperform their peers and benchmarks over extended periods.

The key challenge is distinguishing between skill and luck, between sustainable competitive advantage and temporary outperformance. This distinction forms the core of my investment selection process.

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## Portfolio Construction: Model Portfolios

Over the course of my career, I have avoided dictating to investors what they should believe regarding the passive-active debate. Instead, I have offered model portfolios that generally offer investors five choices (themes). I also offer these five different versions of each model corresponding to five different levels of risk:

	Stocks (%)	Bonds (%)
<b>Aggressive</b>	80	20
<b>Growth</b>	70	30
<b>Balanced</b>	60	40
<b>Moderate</b>	40	60
<b>Income Focused</b>	30	70

Each of these models (and the entire list of funds that meet our high standards) are available to investors that subscribe to my Substack as founding members.

### The Passive Model Portfolio

Investors who do not wish to take any active manager risk can select a purely passive portfolio, which eliminates manager risk by investing solely in broad, low-cost index funds that track major market indices such as the S&P 500.

### The Passive Tax Aware Model Portfolio

The second model portfolio is identical to the first, but swaps out the taxable bond ETFs and replaces them with municipal bond ETFs. This model may be more appropriate for high-tax bracket investors in a taxable account.

### The Multifactor Model Portfolio

The third model is a mostly passive portfolio but also uses funds or ETFs that employ rules-based tilts, which maintains diversification but adds exposure to factors—such as small cap, value, momentum, and profitability—that have historically delivered long-term performance premiums over the S&P 500.

### The Strategic Blend Model Portfolio

The fourth type of portfolio is a blended portfolio that combines passive, rules-based, and selective active management, particularly in asset classes where skilled managers can add value through security selection and risk management.

### The Dynamic Alpha Model Portfolio

The Dynamic Alpha portfolio also uses passive ETFs but leans in a bit more into active managers that meet our high standards.

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## The Active-Passive Debate

Why take any active management risk at all? While most active managers have historically underperformed their respective benchmarks, I feel this is primarily due to the “index fund advantage”. That advantage has three components:

Index funds are

1. Low cost
2. Broadly diversified
3. Fully invested

I feel that there are a small handful of active managers who have the potential to outperform their peers and respective benchmarks that are also low cost, broadly diversified and fully invested. Active managers who do not meet these three criteria usually do not pass our initial screen.

In addition, using rules-based funds or ETFs and selective active managers can help reduce the risk that an investor’s portfolio becomes overly dependent on a small handful of mega-cap stocks that currently dominate the S&P 500. By diversifying across a broader set of companies, sectors, and risk factors, investors can avoid concentrating too much of their portfolio in just a few names and achieve a more balanced return profile.

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## Pursuing a Good Plan, Not a Perfect One

If there are 6–8 funds on our focus list in a particular category (for example, small-cap equities), some investors may find it difficult to choose among them. I suggest you remember the advice attributed to the Prussian general and military theorist Carl (Karl) von Clausewitz: “The greatest enemy of a good plan is the dream of a perfect plan.” While we employ a rigorous due diligence process, there is no single “best” fund in any category. Investors can reasonably select one fund, combine several, or simply use the model portfolios we provide as a practical guide.

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## The Manager Selection Process

Many well-known firms, and many investment professionals, emphasize past performance during the most recent 1-, 3- or 5-year periods. My research has shown this information is virtually useless in identifying future winners and can even lead to worse results than a random selection process. In short, numbers are backward-looking. Fundamentals are forward looking. That’s why my evaluation process is built on two complementary pillars: a quantitative screening (which doesn’t predict future performance but significantly narrows the universe of candidates) and qualitative due diligence. An important distinction between my quantitative process and many well-known ranking systems is the emphasis on risk-adjusted returns and on evaluating performance relative to an appropriate peer group, rather than relying solely on raw returns.

Once I’ve developed a list of funds that pass the quantitative screen, I carefully evaluate their fundamentals across six dimensions: parent, people, process, performance, current positioning, and price. While this approach in no way assures outperformance, my experience has been that it can be an effective process for managing risk and offers investors the potential for outperforming peers and respective benchmarks.

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## Phase One: Manager Screening

Our screening process identifies mutual fund and ETF candidates worthy of further research. This quantitative first step ensures that we focus resources only on managers that deserve our attention.

## Screening Criteria

### Regulatory Oversight and Liquidity

The investment universe is intentionally limited to vehicles that operate under robust regulatory frameworks and provide daily liquidity. Regulation helps protect investors through disclosure requirements, audited financial statements, independent custodians, and ongoing supervisory oversight of portfolio management and trading practices. By focusing on mutual funds and ETFs investors benefit from clear fiduciary duties, standardized reporting, and enforceable compliance structures.

Equally important, mutual funds and ETFs typically offer daily liquidity at transparent prices, allowing investors to adjust portfolios as their needs, risk tolerance, or market conditions change. Liquid, exchange-traded vehicles also reduce the risk of being “trapped” in a position during periods of stress, when access to capital is most critical. In contrast, illiquid, unregulated investments can obscure pricing, limit redemption options, and increase the risk of misalignment between the manager’s incentives and investors’ best interests. For these reasons, the analysis deliberately excludes illiquid and unregistered investments and focuses on regulated mutual funds and ETFs that combine transparency, liquidity, and investor protections.

*Rationale:* Regulatory oversight provides a baseline level of investor protection, disclosure requirements, and professional standards that unregistered vehicles do not offer.

### Minimum Track Record

The investment must have at least five years of audited performance history. We prefer investments that have ten years of history or longer. Exceptions are made if, for example, a fund has ten years of history and the same team manages a new ETF with a similar mandate.

*Rationale:* Five years of performance data allows us to evaluate how a manager performed across different market environments (both rising and falling markets) and to calculate meaningful statistics on volatility, risk-adjusted returns, and downside protection. Shorter records do not provide sufficient data to distinguish skill from luck.

### Stability of the Organization

The portfolio management team should be experienced and credentialed.

*Rationale:* Investment results are heavily dependent on the people responsible for investment decisions. Frequent changes in portfolio management introduce uncertainty about the sustainability of past performance.

### Assets Under Management

The investment should have at least \$500 million under management (across all share classes combined).

*Rationale:* Funds with very small asset bases may have limited research infrastructure, may not be able to support institutional-quality processes, and may face closure risk if assets decline further. Additionally, funds with tiny assets at the time they generated strong performance may not have been able to replicate those results with larger asset bases.

### Composition Consistent with Asset Class

At least 80% of the fund's underlying securities should be consistent with the broad asset class. For example:

- A Large-Cap Growth fund should not hold more than 20% in cash, fixed income, and/or international securities
- A U.S. Bond fund should not hold more than 20% in non-U.S. bonds or equity

*Rationale:* Asset-class consistency ensures that the fund's performance contribution to a diversified portfolio is predictable. Significant holdings outside the asset class (style drift) introduce unexpected risk/return characteristics and undermine the diversification benefits of a multi-asset portfolio.

#### **Style Consistency**

The Style Consistency Metric measures the extent to which a portfolio's position in value-growth and size dimensions has remained stable over time.

*Rationale:* Managers who shift their style significantly over time (e.g., moving from value to growth, or from large-cap to small-cap) introduce uncertainty about what the fund will hold in the future. Stable style profiles allow investors to build a coherent, diversified portfolio.

#### **Expense Ratios Relative to Peers**

The fund's prospectus net expense ratio should not be in the highest cost tier of its peer group.

*Rationale:* High fees relative to peers reduce the net returns available to investors and make outperformance more difficult. We establish a threshold that ensures fees are competitive without necessarily selecting the absolute cheapest option (which may reflect inadequate resources).

#### **Past Performance**

Performance is evaluated over 1-, 3-, 5-, and 10-year periods to gauge both recent results and long-term consistency relative to appropriate benchmarks and peer groups. Industry standards and regulations emphasize these horizons because they reveal how a fund has behaved across different market environments, helping distinguish temporary performance spikes from persistent skill.

#### **Risk-Adjusted Performance: Alpha**

Alpha measures an investment's return relative to what would be expected given its risk exposure to a benchmark. Positive alpha indicates value added beyond the benchmark after adjusting for risk. The fund's risk-adjusted alpha should exceed the peer group median manager's alpha.

*Rationale:* Alpha measures the excess return attributable to the manager's skill, after controlling for the level of risk taken. Funds with alpha above the peer median have demonstrated an ability to add value beyond what would be expected for the level of risk assumed.

#### **Risk-Adjusted Performance: Sharpe Ratio**

The Sharpe ratio is a risk-adjusted return measure calculated as an investment's excess return over the risk-free rate divided by the standard deviation of its returns; higher Sharpe ratios indicate more return earned per unit of volatility. The fund's Sharpe Ratio should exceed the peer group median manager's Sharpe Ratio.

*Rationale:* Funds with Sharpe Ratios above the peer median have generated more return for each unit of volatility—a key indicator of skilled management.

#### **Screening Outcome: The MSS Score**

After reviewing the quantitative characteristics used to evaluate funds and ETFs, the analysis is distilled into a proprietary Manager Section Score (MSS) designed to highlight the strategies most worthy of deeper research. The underlying metrics are not equally weighted; their importance is adjusted based on careful back testing and a thorough review of the academic literature to emphasize those factors with the strongest predictive value. Funds that pass the ManagerSelect screening and achieve attractive MSS results are identified as candidates for qualitative due diligence, while those that fail are generally excluded from further consideration unless there are compelling circumstances that justify an exception, such as a recent management change believed likely to improve results or a new fund led by an exceptional team that merits ongoing monitoring.

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## Phase Two: Qualitative Due Diligence

Quantitative screens are necessary but insufficient. Numbers are backward-looking; they tell us how a manager performed, but not why. Our qualitative due diligence addresses the critical question: Does this manager possess a sustainable competitive advantage or was past performance due to luck or style (a growth fund outperforming the S&P 500 because growth funds overall performed well). We conduct a comprehensive qualitative evaluation across six dimensions: Parent, People, Process, Current Positioning, Performance and Price.

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### Information Sources

Our qualitative due diligence relies on multiple information sources, beginning with the fund's regulatory filings and public materials. The fund's prospectus, fact sheets, and Statement of Additional Information (SAI) should provide most of the information we require to evaluate the Parent, People, Process, Performance, Current Positioning and Price dimensions. These documents offer transparent disclosure of the fund's investment philosophy, portfolio management team, investment process, fee structure, and performance track record.

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### Parent: Investment Culture, Competitive Advantage and Superior Results

Evaluating an investment strategy begins with a close look at the parent organization behind it. A strong investment firm typically demonstrates a well-defined competitive advantage, a clear investment-oriented culture, and a history of delivering attractive results for clients. Investment outcomes are rarely the work of a lone star manager; they usually reflect the collective effort of a broad and deep team, supported by robust research, risk management, operations, and compliance infrastructure.

A well-structured investment firm begins with an investment-driven mission in which generating superior long-term returns for clients clearly takes precedence over maximizing assets under management or firm revenue. The organization should foster a culture of stewardship that consistently places shareholders' interests ahead of salesmanship, product proliferation, or short-term marketing agendas. It should also demonstrate a visible commitment to continuous improvement, with leadership actively refining processes, developing and retaining talent, and adapting thoughtfully as markets and competitive dynamics evolve.

Effective ownership structures align the firm's incentives with those of its clients, often through independent or employee ownership, or by compensating key professionals as if they were owners. The firm should invest adequately in research, technology, risk controls, trading, and operational support so portfolio managers have the tools required to sustain a durable competitive edge. Ultimately, there should be clear evidence that culture, ownership, and infrastructure reinforce one another to support consistent, repeatable decision-making and the potential for superior long-term investment results.

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### People: Experienced, Credentialed, Talented, and Focused

An investment firm's most important assets are its people. The strongest organizations field investment teams that are broad and deep, staffed by experienced, credentialed professionals with meaningful tenure at the firm and within their discipline. The portfolio management team should consist of seasoned investors with clear, demonstrated expertise who are fully engaged in the strategy, rather than stretched across too many mandates or burdened by responsibilities unrelated to investment performance.

Assessment of the team begins with understanding who the key decision-makers are, their backgrounds, and their track records. It is important to evaluate how long the current team has worked together, the depth and quality of the supporting research and analytical staff, and whether those professionals are true specialists in their areas of coverage.

Stability, low turnover, and a thoughtful approach to developing and retaining talent are all signs of a healthy investment culture.

Attention is also given to how the team functions day-to-day: how decisions are made, how disagreements are resolved in team-managed strategies, and whether there is a clear succession plan in place. Red flags include recent departures of key team members, “one-person shops” without adequate backup, insufficient analytical resources, or persistently high analyst turnover. By contrast, a stable, experienced team with a long history of working together, deep research support, strong credentials, and visible development of junior talent indicates that the firm is well positioned to deliver consistent results over time.

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### Process: Repeatable, disciplined approach with strong risk controls

Effective investment organizations rely on a repeatable and well-documented process that emphasizes a deep understanding of companies and markets, rather than attempts to forecast short-term moves in the economy or asset prices. Strong teams apply a clearly articulated investment philosophy consistently over time, allowing their portfolios to reflect fundamental convictions instead of performance-chasing or style drift when conditions change. Managers who can maintain this discipline through both bullish and bearish markets are more likely to deliver outcomes that align with their stated objectives and investor expectations.

A robust process also requires thoughtful portfolio construction and explicit risk management. Security selection, position sizing, and diversification should be systematic and closely tied to the team’s stated philosophy, with turnover levels that make sense for the strategy’s design. Risk controls are not an afterthought; they are embedded in the process and culture through tools and practices that measure, monitor, and manage downside risk, concentration, and exposures across sectors, factors, and geographies.

When evaluating a process, attention is given to how the team responds when the strategy is out of favor: whether it remains faithful to its discipline or reacts by chasing recent winners or abandoning its mandate. Red flags include vague or frequently shifting philosophies, inconsistencies between stated process and actual holdings, high turnover without a clear rationale, and noticeable style drift driven by short-term performance pressure. By contrast, clear and stable philosophy, holdings that line up with that philosophy, reasonable turnover, and systematic, regularly monitored risk controls all indicate a process designed to be consistent, repeatable, and durable over a full market cycle.

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### Current Positioning

Current positioning evaluates how a manager is allocating capital today and whether those choices are consistent with the stated philosophy, process, and long-term track record. This includes an assessment of the portfolio’s factor, sector, style, and geographic exposures relative to its benchmark and peer group, as well as any meaningful tilts that reflect active convictions rather than unintended bets. The goal is to distinguish deliberate positioning—grounded in research and risk controls—from exposures that arise passively from market momentum, crowding, or style drift.

Attention is also given to how the current portfolio is set up for a range of plausible future scenarios, not just the recent past. That means examining the balance between offense and defense, the degree of concentration, liquidity of holdings, and how the strategy may behave in different market environments. Well-reasoned positioning should reflect the manager’s edge and time horizon while remaining aligned with the mandate, risk parameters, and the role the strategy is expected to play in a diversified portfolio.

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### Performance

The strongest investment teams demonstrate a long-term record of consistent, superior results relative to appropriate benchmarks and peer groups, with performance that reflects skill and discipline rather than temporary market

conditions or a few isolated “home-run” stocks. A key objective is to identify managers with a clear, understandable competitive advantage—grounded in their philosophy, process, and resources—that appear durable and capable of being maintained over many market cycles.

Evaluating performance involves looking beyond headline returns to understand how results were generated, whether outperformance is broad-based or concentrated in a single period, and whether it has been achieved at asset levels comparable to those managed today.

Consistency across different market environments, combined with a credible explanation of the team’s edge and evidence that it continues to work in recent years, supports the view that results are repeatable rather than accidental.

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#### Price: Delivering strong value for the price paid

Even an excellent manager creates limited value if fees consume a substantial portion of outperformance. We prioritize managers whose fee structures are reasonable relative to their peer group, allowing investors to retain most of the alpha they generate.

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#### Sell Discipline and The Folly of Manager Rotation

Rapidly rotating among managers based on short-term performance is a "loser's game." Each transaction incurs opportunity costs, tax consequences (in taxable accounts), and the risk of abandoning managers just as they enter a favorable market environment.

In my model portfolios, my intention is to identify managers with sustainable competitive advantages. I expect to hold positions for years or decades, not quarters or years. This long-term commitment aligns our interests with those of our readers and the managers we select.

I believe maintaining a long-term perspective with excellent managers is more productive than frequent trading. However, I maintain a sell discipline to ensure that I exit positions that no longer meet my high standards.

I will sell or significantly reduce a position if:

1. **Change in Portfolio Management:** There is a meaningful change in the professionals directly responsible for portfolio decisions. A management transition removes our confidence in the sustainability of past performance.
2. **Significant Asset Decline:** There is a significant decrease in the fund's assets. Declining assets may signal that other investors have lost confidence, may threaten the viability of the fund, or may indicate that the firm has not successfully retained talent.
3. **Style Drift:** There is clear evidence that the manager is deviating from the stated investment style or strategy. Style drift undermines the diversification benefits of the fund within our portfolio.
4. **Fee Increases:** There is a meaningful increase in the fund's fees and expenses without corresponding improvement in service, performance, or alignment of interests.
5. **Performance Deterioration:** There is evidence of sustained performance deterioration that suggests the competitive advantage may be fading. (Note: We distinguish between temporary underperformance and fundamental deterioration; we do not exit based on short-term underperformance.)
6. **Organizational Change:** Any extraordinary event occurs (ownership change, regulatory action, financial distress, litigation) that may interfere with the manager's ability to fulfill their role.

7. **Philosophical Disagreement:** My assessment of the firm's philosophy, culture, or commitment to investors changes materially.
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## Conclusion: Why This Process Matters

My process is designed to identify skilled managers who I believe possess sustainable competitive advantages and build diversified portfolios that align with investors' long-term financial goals.

I do not pretend to predict the future or to time markets. I do not chase performance or rotate among managers based on recent results. Instead, I undertake the hard work of understanding why managers have succeeded, whether their advantages are sustainable, and whether their interests are aligned with investors.

The result is a list of offerings that is built in a thoughtful, disciplined, and long-term-oriented way. I expect managers to occasionally underperform, and I intend to exercise the discipline to stay invested through temporary underperformance.

This philosophy reflects My core belief: Investment principles triumph over investment predictions. By focusing on sustainable competitive advantages, disciplined processes, and alignment of interests, I believe I can deliver strong long-term results while managing risk appropriately.

To learn more, or to gain access to our list of 90+ mutual funds and ETFs that meet our high standards, as well as our model portfolios, become a founding member of my Substack.

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