THE WALL STREET JOURNAL.
WSJ.com

WEEKEND INVESTOR | APRIL 23, 2011

Can Anyone Steer This Ship?

Once considered the best mutual fund of its time, Fidelity Magellan has been stuck in the doldrums for years. What will it take to right its course?

By ELEANOR LAISE

Harry Lange, manager of the Fidelity Magellan fund, has a prediction for investors wondering if he can turn around that floundering icon of the mutual-fund industry. Ensconced in a quiet 14th-floor conference room with sweeping views of Boston, the 59-year-old Mr. Lange says, "Six months from now, I'll look like I'm a star."

Those are bold words coming from a fund manager who trailed 95% of his large-cap growth-fund rivals for the three years ending in March.

Getty Images & Stephen Webster

The days of star managers like Mr. Lynch raking in assets for fund firms are likely over, analysts say.

Magellan, which helped popularize mutual funds by delivering 29% annualized returns from 1977 to 1990 under star stock-picker Peter Lynch, has been leaking money for more than a decade. From 2000 through last year, the fund had net withdrawals of more than $63 billion, topping every other mutual fund tracked by investment researcher Morningstar Inc. over that period. The fund hit an ignominious low in 2008 when its Morningstar fund rating was dropped to one star on a five-star scale. Its assets now stand at roughly $23 billion.

Magellan is an extreme example of a change that has played out across mutual funds: The classic stock-picking genius who had an uncanny ability to snap up shares just before they soared is growing increasingly irrelevant. And the funds such managers run, once the industry's bread and butter, are struggling to justify their existence.

That is partly because of the higher fees actively managed funds charge, and partly because those funds tend to underperform: In the five years ending in December, 62% of U.S. large-cap funds trailed the Standard & Poor's 500-stock index. Results were even worse for funds focused on smaller stocks, with 63% of small-cap and 78% of midcap funds lagging behind their benchmarks, according to S&P.

The days of star managers like Mr. Lynch raking in assets for fund firms are likely over, analysts say. Magellan, in that sense, "may be the poster child for a bygone industry," says Jim Lowell, editor of Fidelity Investor, an independent newsletter.

Life After Lynch: The Best Funds of the Last 20 Years

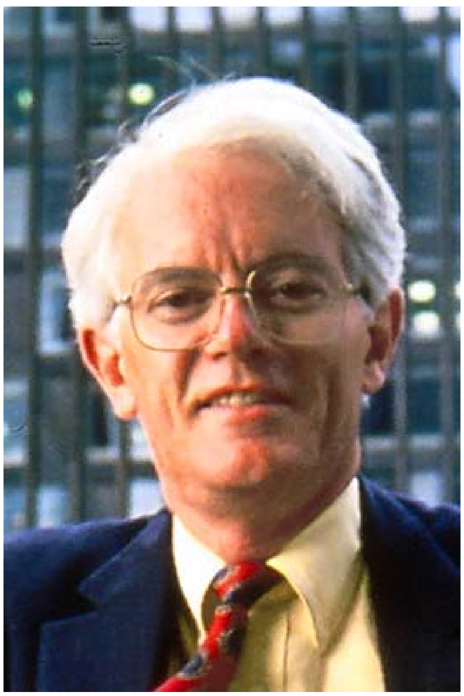
Fund Name (TICKER)	Morningstar Category (U.S.)
Fidelity Low-Priced Stock (FLPSX)	Mid-Cap Blend
Heartland Value (HRTVX)	Small Value
Calamos Growth A (CVGRX)	Large Growth
Neuberger Berman Genesis Inv (NBGNX)	Small Blend
Wells Fargo Advantage Common Stock Inv (STCSX)	Mid-Cap Growth
Federated Kaufmann R (KAUFX)	Mid-Cap Growth

"The jury's out as to whether active domestic management, especially large-cap, will have its day in the sun again," adds Geoff Bobroff, a fund-industry consultant.

Even a historic market rally hasn't convinced investors to favor stock-picking funds like Magellan over their cheaper index-tracking competitors. Although the S&P 500 doubled between early March 2009 and mid-February of this year, its fastest 100% gain since 1936, investors yanked more than $140 billion from actively managed U.S. stock funds in 2009 and 2010—while adding $67.3 billion to U.S. stock-index mutual funds and index-tracking exchange-traded funds.

What's more, even as U.S. stocks continued their climb this year, commodities, bonds and other assets have remained popular with investors. Taxable bond funds attracted roughly $41 billion in net new money in the first quarter of this year, compared with about $25 billion for U.S. stock funds.

All told, investors pulled more than $325 billion out of actively managed U.S. stock funds from 2007 through the end of last year. They pulled more than $18 billion from Magellan over the same period.



Liaison

Star Manager Peter Lynch; 1977-1990

Stock-picking funds, of course, are still big money makers for fund firms. Actively managed U.S. stock mutual funds held about $2.75 trillion at the end of last year and charge average fees of 1.38%, while their index-tracking counterparts held just over $700 billion and charge 0.88% on average.

But most of the growth is in indexing and ETFs: Whereas the number of actively managed U.S. stock funds has fallen to 2,630, the lowest since 1998, the number of U.S. stock ETFs has rocketed from just a dozen in 1998 to well over 500 today.

Low-fee index funds are ascendant even at stock-picking shops like Fidelity. Its Spartan 500 Index fund, at about $43 billion, is now roughly twice the size of Magellan. Ratings firm Moody's Investors Service on April 1 lowered its rating outlook on bonds issued by Fidelity parent FMR LLC to "negative" from "stable," citing poor stock-fund performance and a loss of mutual-fund market share.

Yet Mr. Lange, who started working at Fidelity on the inauspicious "Black Monday" of the 1987 stock-market crash, doesn't seem worried. Asked about his game plan for turning around Magellan, he says, "I feel it has been turned around quite a lot."

Magellan Fund

Average Annualized Performance

Under Peter Lynch: 29%
Under Harry Lange: 2.6% (through 3/31/11)

Magellan's Performance in 2008

Lost 49%, far more than the S&P 500's 37% decline

If he is right, it would be quite a comeback. From the start of Mr. Lange's tenure at the end of October 2005 through March of this year, Magellan gained 2.6% annually, trailing the S&P 500 by 1.5 percentage points a year. It finished in the large-cap growth category's bottom quartile in 2010, according to Morningstar. And it landed in the bottom half of the category again in the first quarter of this year, gaining 5.4%, versus 5.9% for the S&P 500.

These are dismal results for a once-legendary fund. Launched in 1963 and initially managed by current Fidelity chairman Edward

Magellan's Assets

In 2000: Peaked at nearly $110 billion
In 2011: $23 billion

Magellan's Performance in 2010

Trailed 76% of all large-cap growth funds

C. "Ned" Johnson III, Magellan became a household name during Mr. Lynch's tenure. It earned five stars when Morningstar introduced its rating system in 1985.

Fidelity relentlessly touted the fund's results. Magellan had "the performance record no other fund can match," said an advertisement in the September 1991 issue of Kiplinger's Personal Finance magazine, adding that it was "the best performing stock fund in the nation for the 15-year period" ended June 30 of that year. In a footnote, the ad said the portfolio manager had changed on June 1, 1990—marking Mr. Lynch's departure from the fund.

Fidelity Investments

Current Manager Harry Lange; 2005-present

That footnote turned out to be important, since no subsequent manager has come close to measuring up to Mr. Lynch. Robert Stansky, who ran the fund from 1996 to 2005, made Magellan look much like the market benchmark, according to a study by Antti Petajisto, visiting assistant finance professor at New York University's Stern School of Business. A Fidelity spokesman says "there are many ways in which the fund's investments regularly differed from the S&P 500" during Mr. Stansky's tenure.

Fidelity closed Magellan to new investors in 1997. Assets topped out at almost $110 billion in 2000. But investors pulled money out of the fund that year, and they haven't stopped since.

Investors and analysts had high hopes for a Magellan revival when Mr. Lange took the helm at the end of October 2005. He had delivered strong returns at his previous fund, Fidelity Capital Appreciation, where he was known for swooping into beaten-down tech stocks in 2002 and riding them to category-topping returns in 2003.

At Magellan, Mr. Lange immediately made the fund look far different from the index. The fund's "active share," which measures the percentage of fund assets that are invested differently from the index, climbed to 66% from 40% in the last few months of 2005, according Mr. Petajisto's study.

But while looking different from the index should be a requirement for any active manager, Mr. Lange quickly demonstrated that it doesn't guarantee market-beating returns. Magellan gained about 7% in 2006, less than half the S&P 500's return. It quickly turned around and climbed nearly 19% in 2007, compared with a 5.5% gain for the S&P.

On the heels of that strong year, Fidelity in January 2008 reopened Magellan to new investors. But new shareholders arrived just in time to see Magellan lose 49% in 2008, far more than the S&P 500's 37% decline. The main problem: Mr. Lange loaded up on beaten-down financial stocks like American International Group Inc. and Bank of America Corp. Those turned out to be some of his biggest losers in his first five years at the fund, says Morningstar analyst Christopher Davis.

The 2008 performance was the final straw for some shareholders, including Pat Trainor, a 50-year-old sales engineer in Norwich, Conn. He first invested in Magellan in the mid-1990s, and kept rolling his 401(k) accounts into the fund as he went through a series of employers. By November 2008, he had had enough.

Frustrated with Magellan's failure to protect shareholders from the downturn, he says, he finally rolled his 401(k) money into an individual retirement account at a brokerage firm, where he uses trading software to pick his own stocks—generally with a time horizon of about 10 to 30 days.

Morningstar Fund Ratings

Five Stars December 1985

Four Stars September 1992

Three Stars April 1996

Two Stars June 2004

One Star November 2008

The mutual-fund industry is "asleep at the wheel and just counting their money," Mr. Trainor says. "I lost my faith in Fidelity and all mutual funds."

Yet Mr. Lange isn't kicking himself for his missteps during the financial crisis. "I didn't think our financial system would come close to a meltdown," he says. "I don't know how many people did."

He adds, "If I saw that again, I would buy it again."

Mr. Lange's contrarian streak has occasionally paid off for Magellan shareholders. He loaded up on beaten-down General Electric Co. in early March 2009, after the company had cut its dividend. Magellan "ended up getting a quick double on the stock," he says.

On the whole, however, the market upswing since early 2009 hasn't been a smooth ride for Magellan. The fund gained 41% in 2009, beating the S&P 500 by 15 percentage points and landing in the large-cap growth category's top quartile. But the fund lagged behind the benchmark by 2.7 percentage points last year, falling back to the bottom quartile.

Mr. Lange remains so confident in his growth-oriented investment approach that he isn't making any changes now. While periods of higher volatility may not be suited for his style, "I just hunker down, find the best stocks, and eventually it works its way back out," he says.

His current favorite sectors include consumer electronics, home builders and gold. He likes consumer electronics, he says, partly because millions of people in China are moving from rural areas to cities, "and all of a sudden they have money to buy cellphones and TVs and even cars." Regardless of the U.S. economy's health, he says, "China's still going to have people moving, and their economy, I think, will still do pretty well."

While he's predicting a Magellan resurgence, Mr. Lange's personal investments in recent years haven't indicated much faith in the fund. He had between $500,000 and $1 million invested in the fund as of March 31, 2010, the latest data available in regulatory filings.

While that is more than the $100,001 to $500,000 range he had invested a year earlier, it doesn't measure up to most other major fund managers. A recent Morningstar study found that 39 of the 50 largest actively managed funds have at least one manager with more than $1 million invested in the fund.

Mr. Lange says he has normally had more than $1 million in Magellan but had only about $600,000 invested after cashing out some of his holdings to buy a condominium in Tokyo. A Fidelity spokesman added that Mr. Lange's Magellan holdings had recently been boosted to more than $1 million.

Mr. Lange maintains that Magellan's performance numbers will look much better in six months' time, because most of its dismal 2006 and 2008 results will disappear from its three- and five-year track record.

Analysts disagree. "It's in such a hole performance-wise, the long-term numbers are going to look bad for a long time," Morningstar's Mr. Davis says.

If the fund continues to underperform, Mr. Lowell says, Fidelity is likely simply to close it to new investors once again, and "keep it like Jeremy Bentham's head in a glass case, so people can remember the good old days."

Write to Eleanor Laise at eleanor.laise@wsj.com