



GovernanceMetrics International



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Corporate Governance as a Factor in Mutual Funds Holdings

New York, January 12, 2004 Managers of large-cap mutual funds tend to overweight their portfolios with companies with above-average corporate governance profiles according to research by Lipper, the leading global fund research firm, and GovernanceMetrics International, the world's first global corporate-governance ratings agency.

Moreover, those funds that are heavily overweighted in well-governed companies have outperformed the average fund in both three- and five-year holding periods and tend to do better than funds with a large number of poorly governed companies in their portfolios over the same periods. The outperformance does not hold over the one-year time frame.

The two firms paired the stock holdings of 725 large-cap domestic equity mutual funds portfolios in Lipper's database with the governance ratings calculated by GMI for more than 1,000 publicly traded firms.

Lipper and GMI looked at each fund's allocation to stocks with high (favorable) governance ratings and those with lower governance ratings. GMI's ratings range from 1 to 10, with stocks receiving a 10 typically having truly independent boards of directors, influential and independent audit and compensation committees, and other good-governance characteristics.

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Structures and policies that limit the independent directors' ability to oversee management (or actions indicating that the board has not been effective in governing the firm) will lower a stock's governance rating. GMI's ratings are relative to other stocks in their rating universe.

So, in evaluating fund holdings, Lipper compared them with GMI's ratings distribution. GMI currently rates approximately 1,000 U.S. stocks, including all of the S&P 500 components, all of the S&P Midcap 400 components, and other widely held stocks. GMI's ratings for non-U.S. stocks were not included in this analysis, which looked only at domestic funds.

Among the large-cap funds with the strongest average governance ratings for portfolio stocks, the funds with the highest 3-year annualized returns were:

- Sequoia
- Northern Funds Lg. Cap Value
- Hennessey Total Return
- ING Corporate Leaders
- TD Waterhouse Dow 30

And among the large-cap funds with the poorest average governance ratings, the funds with the lowest 3-year annualized returns were:

- ASAF ProFund Managed OTC
- Van Kampen Select Growth
- Jundt Twenty-Five
- Gartmore Focus
- Janus Mercury

Lipper also uses its signature Lipper Leader rating system to evaluate funds versus peers according to five separate criteria, with each fund receiving a rating from 1 (best) to 5 (worst) for each of the system's five criteria. Sean McLaughlin, a Lipper spokesman, said, "For all three large-cap fund styles (value, core and growth), the funds with large holdings of poorly governed firms had lower total return ratings and poorer risk ratings than those that placed their bets with better-governed stocks. The differences were not always statistically significant, but based on this sample, managers who shun low-rated stocks generally fared better than their counterparts who have higher holdings in tainted firms. This was not the case for one-

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year returns, but this was not surprising given the tech-stock rally and the fact that as a group, tech stocks tend to have lower-than-average governance profiles.”

Gavin Anderson, President of GMI said, “This research is yet another indication of the relationship between governance practices and performance. Mutual fund investors should be asking their managers to disclose the governance profile of their funds. It is an investment risk they should be made aware of.”

About GovernanceMetrics International

GovernanceMetrics International (GMI) is the only independent corporate governance ratings agency focusing on corporate accountability issues on a global scale. Its ratings are based hundreds of data points per company and cover seven broad categories of analysis. Ratings criteria are based on a number of well-regarded global corporate governance codes, including those developed by the Organisation for Economic Cooperation and Development (OECD).

About Lipper

Lipper, a wholly owned subsidiary of Reuters, is a leading global provider of mutual fund information and analysis to fund companies, financial intermediaries, and media organizations. Lipper clients manage more than 95% of U.S. fund assets. The firm, founded in 1973 and headquartered in New York, tracks 115,000 funds worldwide through its offices in major financial capitals in North America, Europe, and Asia.

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