This back page is where I explain an element of the evaluative process I continually employ as I search for productive investments.

One of the metrics I review regularly is the capture ratio. An upside capture ratio measures the fund's overall performance in up markets relative to an index, typically the S&P 500. A downside capture ratio measures how much of a market loss the fund absorbs during bear markets. The delta, or difference between the two, is the capture ratio.

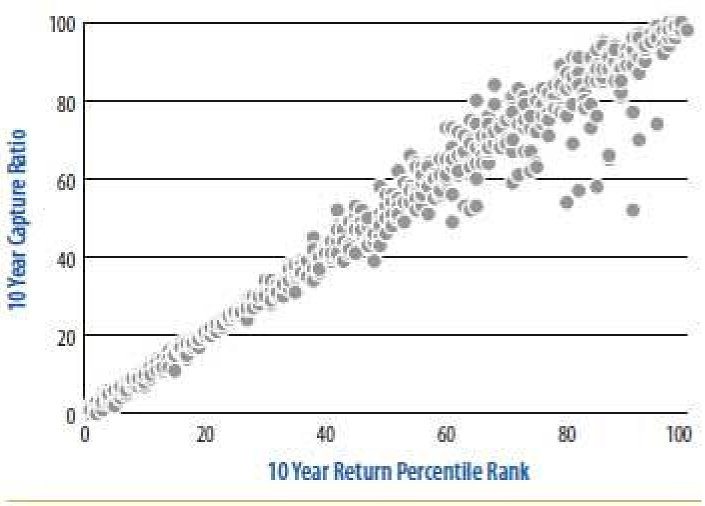
For example, a fund with an upside capture ratio of 110% indicates that the fund outperformed the index during a bull market by 10% (good). Conversely, a downside capture ratio of 130% would show the fund absorbing 30% more loss than the index during a bear market (bad).

We look for:

1. Positive capture ratios (meaning the up ratio is greater than the down), and
2. Large capture ratios, regardless of risk level.

The figure below illustrates the relationship between the 10 yr capture ratio, and the 10 yr return ranking. The clear linear relationship indicates that a larger capture ratio can be a reliable indicator of historical performance. While one ratio never tells the whole story, the capture ratio is an important ingredient for comparing mutual funds, and analyzing which investments can be a suitable part of your overall portfolio.

Figure 3



Source: Morningstar, August 31, 2009