

Virtual portfolio boasts solid returns, multiple stars from Morningstar

But some skeptical observers say Marketocracy is just a fad

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After more than seven years of tapping into the Internet for the best stock pickers who are willing to run a virtual portfolio, Marketocracy Inc. has produced a top-tier mutual fund that is loosely subadvised by an eclectic group of individuals, most of whom have no connection to Wall Street.

Despite skepticism among some industry purists related to its unorthodox approach, the Marketocracy Masters 100 Fund (MOFQX) is becoming increasingly difficult to ignore.

From its November 2001 inception through April 2008, the \$40 million fund produced an average annualized return of 9.7%, compared with a 5.5% annualized return for the Standard & Poor's 500 stock index.

Morningstar Inc. of Chicago has rated the fund four stars over the five-year period and five stars over three years, yet no analyst there has taken a close enough look even to comment on Marketocracy's strategy.

At Lipper Inc. in New York, the general sense is that such a faddish idea doesn't have a bright future.

"I'm surprised this fund has lasted as long as it has," said Jeff Tjornehoj, research manager at Lipper.

The fund, which is officially managed by Ken Kam, founder and chief executive of San Mateo, Calif.-based Marketocracy, allocates assets to models of 100 virtual portfolios in proportions based on fundamental and quantitative analysis.

"This fund was designed to be very diversified, which is why we use 100 people to drive the fund," he explained. "We decide how much weight to give each manager, and we will skew the portfolio toward those managers who are performing well and are the most persuasive on our online forums."

Although no real money is used in the virtual portfolios, in order to qualify, participants must follow basic compliance standards, including deductions for trading costs.

The fund includes 198 positions and has an annual turnover rate of about 100%.

The 100 virtual portfolios average 20 positions and combine for almost 2,000 companies, with 500 stocks appearing in more than one portfolio, according to Mr. Kam.

"Any security that becomes more than 2% of the mutual fund portfolio is subject to another level of research," he said.

The original idea behind Marketocracy, according to Mr. Kam, was to create a way for portfolio managers to develop personal track records that follow them regardless of where or how they are managing money.

"We know that in the mutual fund world, 70% of the portfolio managers haven't even been there five years," he said.

Mr. Kam's answer to what he saw as a need for manager-specific track records was to invite all comers to sign up free of charge at marketocracy.com to manage a virtual \$1 million portfolio.

Since July 2000, more than 100,000 people have taken the challenge, and of those, more than 30,000 have developed track records of at least five years.

'NO SHORT CUTS'



Ken Kam: "Just because it's virtual doesn't mean it isn't real."

Research contracts have been awarded to 500 participants, allowing them to earn a small portion of the mutual fund's income stream, even though only the models of the top 100 portfolios are included in the mutual fund.

"There are no short cuts here," Mr. Kam said. "If you want a five-year track record, it's going to take five years."

The underlying managers represent a wide cross section of what you might expect from an Internetwide casting call.

Just 15% of the Marketocracy managers work in the financial services industry, and more than 90% of the participants are male.

One recent theme that has been developing for top performers is job offers.

"I get job offers all the time, and it's a wonderful compliment. But until I find a company that lets me build portfolios any way I want, I don't have a keen interest in getting involved," said Randolph McDuff, a 43-year-old retired stockbroker from The Pas, Manitoba. He started managing his first virtual portfolio the same month that Marketocracy opened — July 2000.

Mr. McDuff's 35.5% average annualized return through June 13 would have turned that original \$1 million into \$11.4 million today.

Then there is Timothy Siegel, a 51-year-old self-employed patent attorney from Bellevue, Wash., who bases some of his investing on what he sees come across his desk in the form of invention ideas.

"Being a patent attorney provides a fascinating window [into] the business world," he said. "I just feel that too many stock analysts focus on things like public company documents, where much of the

marrow has already been sucked out of those bones."

TRACK RECORD IS KEY

Mr. Siegel, who launched his first Marketocracy portfolio in August 2003, generated an average annualized return through June 13 of 38.1%, compared with an annualized return of 7% by the S&P 500.

From a financial advisers' perspective, the established track record is a key component, according to Theodore Feight, owner of Creative Financial Design in Lansing, Mich.

"The fund is doing an extremely good job in a very volatile period, but I would be much more interested if I knew who the underlying managers were," he said. "The idea makes sense because you can get anything off the web, but you have to make sure there's a real track record."

One immediate downside Mr. Feight pointed out is the fund's above-average 1.95% management fee.

Since January, the virtual portfolios of 12 of the best-performing virtual managers have been made available to investors willing to plunk down \$50,000 in a separately managed account format.

So far, \$5 million has been allocated to the top managers, and Mr. Kam said he expects that number to double by the end of the month.

"All along the way, people have been skeptical, but I would rather have somebody with a virtual five-year track record than somebody with an MBA from the finest business school and no track record," he said. "Just because it's virtual doesn't mean it isn't real."

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