

The Determinants of Persistence in Mutual Fund Performance

Ariadna Dumitrescu
ESADE Business School

Javier Gil-Bazo
University Pompeu Fabra

Abstract

Equilibrium in the market for mutual funds requires that performance differences across funds be unpredictable. Berk and Green (2004) have hypothesized that cross-sectional differences in performance will be arbitrated away if investors' money flows to funds with the highest expected performance and there are diseconomies of scale in portfolio management. In contrast, the available empirical evidence suggests that performance persists through time for the worst-performing funds and, to a lesser extent, for the best-performing funds. In this paper, we use data on US equity mutual funds in the 1991-2010 period to investigate whether market imperfections such as search costs, information processing costs, switching costs, and investor inattention can explain mutual fund performance persistence. Our results suggest that differences in performance across funds are more persistent among retail funds and funds with higher expense ratios, consistently with investors in those funds facing higher search costs and information processing costs. Switching costs, as proxied by back-end loads, are also associated with more persistence. However, we find no evidence of less persistence among more familiar products, such as those offered by larger and older fund families. Aggregate available information, as proxied by the number of lagged media articles and advertising expenditures, is associated with lower persistence. We find mixed evidence that investor attention reduces performance persistence.