How Does Size Affect Mutual Fund Performance? Evidence from Mutual Fund Trades*

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ABSTRACT

Larger mutual funds underperform their smaller counterparts due to their holdings and not due to higher transaction costs. Using a sample of actual fund trades combined with fund portfolio holdings we find that larger funds experience lower percentage transaction costs than smaller funds. Further, smaller funds hold smaller market capitalization stocks and, to a lesser extent, stocks with greater book-to-market ratios and higher momentum. It is these characteristics, especially the market capitalization of stock holdings that account for diseconomies of scale in the mutual fund industry.

Keywords: Mutual funds, transaction costs, fund size, stock size, fund performance

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