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ABSTRACT

Mutual fund portfolio managers do not always meet performance expectations, resulting in loss of capital reserves. Out of 3,612 U.S. based open-ended mutual funds, the risk-adjusted performance of 2,890 (80%) failed to meet the S&P 500 performance between the year 2006 to 2016. Grounded in Markowitz’s modern portfolio theory, this correlational study examined the relationship between mutual fund class type, portfolio turnover, fund longevity, management turnover, and annual fund risk-adjusted performance. Archival data were collected from 88 U.S. based equity mutual funds companies. The results of the multiple regression analysis indicated the model as a whole was able to significantly predict annual fund risk-adjusted performance for the 5-year period ending 2016, F (4, 83) = 3.581, p = .010, R2 = .147. In the final model, mutual fund class type and portfolio turnover were statistically significant with mutual fund class type (β= .249, t = 2.302, p = .024) accounting for a higher contribution to the model than portfolio turnover (β = .238, t = 2.312, p = .023).

KEYWORDS

Equity Funds, Fund Longevity, Management Turnover, Mutual Fund Class Type, Portfolio Turnover, Risk-Adjusted Mutual Fund Performance

1. INTRODUCTION

The goal of a fund manager is to maximize fund performance (Brooks, 2016). Mutual fund portfolio managers’ role includes: managing the portfolio, selling and marketing funds, selecting and retiring funds, and overseeing compliance with regulations (Kostovetsky & Warner, 2015). Fund managers are the ultimate decision-makers in maximizing portfolios return (Brooks, 2016; Franco, 2014; Kostovetsky & Warner, 2015). Fund managers struggled to beat performance metrics, such as the S&P 500 (Franco, 2014; Kostovetsky & Warner, 2015; Junarsin, 2013). Hence, the concern of mutual fund managers is to improve their ranking and consequently attain pecuniary rewards.

The goal of investors is to maximize their portfolio return by minimizing their risk exposure (Lee, 2013). Assuming the acceptable risk-return tradeoff in finance, an investor with a focus on return would invest in highly risky assets to gain higher performance and vice-versa (Nyberg, 2013).

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Nyberg (2013) identified the positive relationship between the investor’s perception of return and the level of expected risk to attain the return. The concept of modern portfolio theory (MPT) would apply towards investing in clients’ financial assets in the market (Berk & DeMarzo, 2013). The mutual fund industry performance operates through the transition risks level, but without emphasizing on the long-term test of the market (Lee, 2013). Thus, Lee (2013) recommended for the mutual fund industry to strengthen risk management strategy and pursue performance sustainability.

In agreement with Section 15(c) of the Investment Company Act of 1940, fund managing companies’ need to report core elements of performance and expenses related to advisor fees, fund expenses, portfolio turnover, and investment portfolio performance (Kostovetsky & Warner, 2015). Investors use this information to make investment decisions related to where to invest. The basis for mutual fund managers’ performance includes asset growth and portfolio returns. Lower performance might lead to compensation reduction or separation (Munoz et al., 2014). The compensation reduction is critical for highly managed funds (i.e., Class A) that requires an upfront load, which reduces the investment return (Munoz et al., 2014). Highly managed funds generally have a high portfolio turnover with frequent buy and sell decisions; fund manager decisions are not always successful (Beyhaghi & Hawley, 2013). During the period between 1995 and 2015, 13,627 internal fund managers and subadvisors departed from their position as financial advisors because of underperformance (U.S. Securities and Exchange Commission, 2015). Thus, the purpose of this quantitative correlation study is to examine the relationship between mutual fund class type, portfolio turnover, fund longevity, management turnover, and annual fund risk-adjusted performance for the 5-year period ending 2016.

1.1. Evaluation of Portfolio Managers

Through October 2008, managers of large publicly traded financial institutions reported a loss of $700 billion (Amuedo-dorantes & Pozo, 2015) and the estimated loss to investors during the 2008-2009 recession was over $2 trillion (Brooks, 2016; Franco, 2014). Consequently, fund managers lost capital because of clients’ withdrawal and evaporation of fund value from declining stock prices (Munoz, Vargas, & Marco, 2014). However, during this same period, some fund managers survived the financial crisis and attracted substantial additional capital (Franco, 2014). Thus, the decisions of mutual fund managers impact the success of a fund (Munoz et al., 2014). Mutual fund managers, however, do not always meet performance expectations, resulting in loss of capital reserves and potentially the loss of their jobs (Munoz et al., 2014).

1.2. Problem Statement

Mutual fund portfolio managers do not always meet risk-adjusted performance expectations, resulting in loss of capital reserves (Munoz et al., 2014). Out of 3,612 U.S. based open-ended mutual funds, the risk-adjusted performance of 2,890 (80%) failed to meet or beat the S&P 500 (index fund) performance between the year 2006 to 2016 (Ying-Fen & Hai-Ching, 2017). The general business problem is a low risk-adjusted performance of mutual fund portfolio may cause investors to withdraw their financial asset under management. The specific business problem is that some portfolio managers do not know the relationship between mutual fund class type, portfolio turnover, fund longevity, management turnover, and annual fund risk-adjusted performance for the 5-year period ending 2016.

2. REVIEW OF LITERATURE

There are several works of literature related to mutual funds using modern portfolio theory (MPT) as the basis for their study. The MPT is the theoretical framework for this study. Markowitz (1952) was the first to publish related to the development of the theory of MPT. In 1952, Markowitz identified the technique referred to portfolio selection and validated the efficient frontier. The concept of MTP, however, changed significantly from the original idea of 1952 in that the present investment professionals and investors evolved to use new theories in line to MPT (Franco, 2014). In 1958, the
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