CBR BRIEFING #75

Why active-mutual-fund portfolios increasingly look like indexes

➜ When investors consider the liquidity of a stock portfolio, they should think not only of the liquidity of the underlying stocks, but also to what extent the portfolio is diversified, according to Chicago Booth's Lubos Pastor and University of Pennsylvania's Robert F. Stambaugh and Lucian A. Taylor.

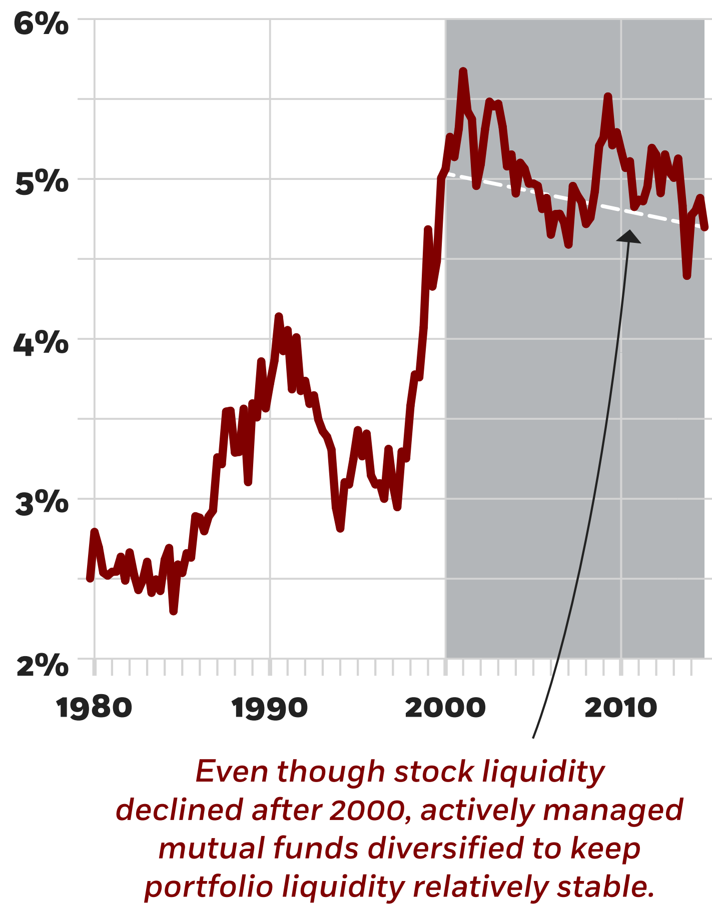
➜ The researchers used this idea to derive a measure of a portfolio's liquidity and analyze data from 2,789 actively managed mutual funds going back to 1979.

➜ During this period, fund portfolios became more liquid, the researchers find. But while the liquidity of individual stocks has declined since 2000, the portfolios' level of diversification has increased sharply.

➜ This increasing diversification captures a rise in "closet indexing" among active-mutual-fund managers—they hold stocks that cover more and more of the market and assign weights that increasingly resemble market benchmarks.

Portfolio liquidity: an indicator of a stock portfolio's trading costs, given the fund's size and turnover

100% = most liquid, with lowest trading costs



Lubos Pastor, Robert F. Stambaugh, and Lucian A. Taylor, "Fund Tradeoffs," NBER working paper, December 2017.

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