The Determinants of Mutual Fund Performance: A Cross-Country Study*

Miguel A. Ferreira†
NOVA School of Business and Economics

Aneel Keswani
Cass Business School

António F. Miguel
Lisbon University Institute

Sofia B. Ramos
Lisbon University Institute

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Abstract

We use a new data set to study the determinants of the performance of open-end actively managed equity mutual funds in 27 countries. We find that mutual funds underperform the market overall. The results show important differences in the determinants of fund performance in the U.S. and elsewhere in the world. The U.S. evidence of diminishing returns to scale is not an universal truth as the performance of funds located outside the U.S. and funds that invest overseas is not negatively affected by scale. Our findings suggest that the adverse scale effects in the U.S. are related to liquidity constraints faced by funds that, by virtue of their style, have to invest in small and domestic stocks. Country characteristics also explain fund performance. Funds located in countries with liquid stock markets and strong legal institutions display better performance.

JEL classification: G15; G18; G23

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†Corresponding author. Address: Faculdade de Economia, Campus de Campolide 1099-032 Lisboa, Portugal. E-mail: miguel.ferreira@fe.unl.pt.

1. Introduction

Mutual funds have come to play a dramatically increased role in financial markets in recent decades. As of the end of 2007, the world mutual fund industry managed financial assets exceeding $26 trillion (including over $12 trillion in stocks), more than four times the $6 trillion of assets managed at the end of 1996 (Investment Company Institute (2008)). The number of mutual funds has also grown dramatically, to more than 66,000 funds worldwide at the end of 2007 (including nearly 27,000 equity funds). Although the growth of the mutual fund industry started in the U.S., where the industry plays an extremely important role in financial markets, this trend has spread more recently to other countries around the world (Khorana, Servaes, and Tufano (2005)). The share of assets under management outside the U.S. grew from 38% in 1997 to 54% in 2007.

Investors are increasingly interested in mutual fund selection, demanding detailed mutual fund information and investment advice. Many authors have tried to explain the performance of mutual funds, which is a critical aspect in investor fund selection. Several fund characteristics have been analyzed as potential determinants of future fund performance, including fund size, age, fees and expenses, loads, turnover, flows, and returns.[1] Most authors conclude that mutual funds underperform the market, but some others find that managers display some skill. In particular, there is evidence of short-term persistence in funds' performance and that money flows to past good performers. Investors display some fund selection ability as they tend to invest in funds with subsequent good performance ("smart money" effect). There is also evidence that fund performance worsens with fund size (Chen, Hong, Huang, and Kubik (2004)) and fees (Gil-Bazo and Ruiz-Verdu (2009)). Although the literature focuses on the U.S. mutual fund industry, several authors study fund performance in individual countries. Few, however, examine cross-country mutual fund performance.[2]

[1] See, for example, Jensen (1968), Grinblatt and Titman (1989), Ippolito (1989), Hendricks, Patel, and Zeckhauser (1993), Brown and Goetzmann (1995), Malkiel (1995), Gruber (1996), Carhart (1997), Chevalier and Ellison (1997), Sirri and Tufano (1998), and Zheng (1999).

[2] See, for example, studies on Australia by Bird, Chin, and McCrae (1983); France by Dermine and Roller (1992); Italy by Panetta and Cesari (2002); Japan by Cai, Chan, and Yamada (1997); Sweden by

We study how the performance of equity mutual funds relates to fund characteristics and country characteristics around the world. To the best of our knowledge, we are the first to study mutual fund performance using a worldwide sample of funds. The sample consists of 16,316 open-end actively managed equity funds in 27 countries over 1997-2007. We focus on the sample of funds that invest in their local market (domestic funds), but we also perform some tests using funds that invest outside their local market or globally (international funds). We use the Carhart (1997) four-factor model to measure risk-adjusted performance, but we also consider several alternatives including benchmark-adjusted returns, market-adjusted returns, and the market model.

We study fund performance using an extensive list of fund characteristics, including fund and family size, age, fees and expenses, front-end and back-end loads, flows, past returns, management structure, and number of countries where a fund is sold. There are reasons to believe that there are important differences in the determinants of mutual fund performance between the U.S. and the rest of the world. U.S. funds are much larger than elsewhere in the world, and the U.S. fund industry is older and more developed. Our worldwide sample of mutual funds allows us to consider several country characteristics, such as economic development, financial development, quality of legal institutions and law enforcement, and mutual fund industry structure, as potential determinants of performance.

We first document that equity mutual funds around the world underperform on average by 20 basis points per quarter after fees and controlling for the Fama and French (1992) three factors and momentum. We find evidence of important differences in the determinants of mutual fund performance in the U.S. and elsewhere in the world. The most striking difference is related to the effects of scale. We find that small funds perform better than large only in the case of U.S. funds, as large non-U.S. funds perform better than smaller funds. The negative size effect in the U.S. is economically significant, as a one-standard

Dahlquist, Engström, and Söderlind (2000); or the U.K. by Blake and Timmermann (1998). Grunbichler and Pleschiutschnig (1999) and Otten and Bams (2002) study European equity mutual funds, but their findings on performance are narrow because of both a small number of countries and funds.

deviation increase in fund size yields a 15 basis point decline in the next quarter's fund return. The positive size effect outside the U.S. is also sizable. A one-standard deviation increase in fund size is associated with an increase in next quarter's fund net return of 11 basis points. Additionally, fund size does not seem to hurt the performance of funds that invest overseas. We conclude that the U.S. evidence on diseconomies of scale (Chen et al. (2004)) is not a universal truth as non-U.S. funds and international funds do not seem to be affected by diminishing returns to scale.

Of course, U.S. funds are much larger on average than funds elsewhere in the world. The average U.S. fund is more than five times larger than the average non-U.S. fund.[3] This fact, however, does not explain the asymmetric effect of scale on performance as U.S. funds of similar size to their non-U.S. counterparts also present a significant negative relation between performance and lagged fund size. Our findings suggest that liquidity constraints play an important role in explaining the lack of scale-ability of fund investments as argued by Chen et al. (2004), Pollet and Wilson (2008), and Yan (2008). U.S. funds that, by virtue of their style, have to invest in small (and illiquid) stocks are the most affected by scale, while this is not the case for non-U.S. funds. Moreover, the performance of international funds is not negatively affected by scale even for those funds located in the U.S. It is important to note that U.S. international funds' average TNA is similar to the U.S. domestic funds' average TNA. This suggests that the availability of more investment opportunities in funds that invest overseas mitigates the adverse scale effects. In other words, international funds are not restricted geographically in investment opportunities as a fund grows, while domestic funds are restricted geographically.

These findings are informative about the relevance of the Berk and Green (2004) model around the world. The Berk and Green (2004) model assumes that funds operate in a decreasing return to scale environment, which means that fund flows harm rather than improve subsequent fund performance. Our findings that diminishing returns to scale may

[3]There are only nine non-U.S. funds among the top 100 domestic equity funds in terms of total net assets (TNA) at the end of 2007 in our sample.

not be present outside of the U.S. mutual fund industry suggest that fund flows may not eliminate performance persistence in the manner predicted by the Berk and Green (2004) model.

We also consider the effect of the size of the fund family on fund performance around the world. Many funds belong to large fund families and some of these families manage funds in several different countries (examples of top fund families are American Funds, Barclays, Fidelity, and UBS). Controlling for fund size, we find that fund performance actually improves with the size of its fund family, as large fund families benefit from substantial economies in trading commissions and lending fees. Chen et al. (2004) find similar evidence for U.S. funds. We also test the hypothesis that organizational diseconomies, in particular hierarchy costs (Aghion and Tirole (1997) and Stein (2002)), erode fund performance. Large organizations with hierarchies are particularly inefficient in processing soft information, which is pivotal in the case of mutual funds, as managers may have a hard time convincing others to implement their ideas. Consistent with this view, we find evidence that solo-managed funds perform better than team-managed funds in a worldwide sample of funds, which is consistent with the U.S. evidence in Chen et al. (2004).

Other fund characteristics have a variety of effects on performance. Fund age is negatively related to fund performance in the sample of non-U.S. funds, but this relation is statistically insignificant in the sample of U.S. funds. This indicates that younger funds are better able to detect good investment opportunities outside the U.S. We also examine the effects on fund performance of past performance and flows. We find evidence of short-run persistence in fund performance, but only in the case of U.S. funds. The evidence on persistence is consistent with the U.S. evidence (e.g., Hendricks et al. (1993) and Grinblatt and Titman (1994)). Investors outside the U.S. seem to have some ability to select funds, as money flows to funds with good future performance. We find, however, that the "smart money" effect is statistically insignificant in the sample of U.S. funds. This is consistent with the U.S. evidence in Sapp and Tiwari (2004) that the "smart money" effect is explained by

momentum.

A unique feature of our study is that we can investigate the effect of country characteristics on fund performance. We find country characteristics to have predictive power beyond fund characteristics. There is a strong positive relation between the performance of mutual funds and a country's level of financial development. In particular, funds perform better in countries with high trading activity and low trading costs. Finally, we find that funds domiciled in countries of common-law tradition perform better. Investor protection and law enforcement have a significant and positive effect on fund performance. Our findings show that country-level investor protection is a critical determinant of the performance of the mutual fund industry across countries in addition to the size and fees of the industry (Khorana et al. (2005) and Khorana, Servaes, and Tufano (2009)).

The remainder of the paper is organized as follows. Section 2 describes the data and the performance benchmarks. In Section 3 we present our empirical findings. Section 4 concludes.

2. Data and Methodology

In this section, we first describe our sample, then we describe the methods for computing abnormal performance and finally we present fund and country characteristics.

2.1 Sample Description

Data on equity mutual funds come from the Lipper Hindsight database, which covers many countries worldwide in the 1997-2007 period. The database is survivorship bias-free, as it includes data on both active and defunct funds. Although multiple share classes are listed as separate funds in Lipper, they have the same holdings, the same manager, and the same returns before expenses and loads. We eliminate multiple classes of the same fund to avoid multiple counting of returns. We keep the share class that Lipper identifies as the primary

one. The initial sample includes 37,910 primary equity funds (both active and dead funds).[4]

We have checked the coverage of funds by Lipper with the aggregate statistics on mutual funds (European Fund and Asset Management Association (2008), EFAMA). Total numbers of equity funds reported by Lipper and the EFAMA are, respectively, 26,800 and 26,950 as of December 2007. Total net assets of equity funds (sum of all share classes) reported by Lipper and EFAMA are, respectively, $10.9 trillion and $12.5 trillion as of December 2007. Thus, our initial sample of equity funds covers 87% of the total net assets of worldwide equity funds. There is, however, some variation in coverage across countries. While Canada, Germany, Sweden, the U.K., and the U.S. have coverages above 90%, the coverage in Australia and France is roughly 60% and in Japan only 40%.[5]

We exclude off-shore funds (e.g., funds domiciled in Luxembourg or Dublin), closed-end funds, index-tracking funds, exchange-traded funds, and funds-of-funds. This gives a sample of 25,110 open-end actively managed equity funds from 34 countries. We require mutual funds to have data on total net assets (TNA), age, total expense ratios, front-end and back-end loads, flows, management team, the number of countries a fund is sold, and monthly total returns. We also require a fund to have at least two years of reported returns because we need to estimate fund factor loadings based on past fund returns. The final sample includes 16,316 funds in 27 countries (12,577 active funds and 3,739 dead funds as of December 2007). We believe this is the most comprehensive data set ever used to study mutual fund performance in terms of both number of funds and countries. The data set allows us to investigate the effect of both fund characteristics and country characteristics on performance.

The Lipper database provides information on a fund's country of domicile and geographic investment focus. We use these data to classify funds in terms of their geographic investment

[4]The primary fund is typically the class with the highest total net assets (TNA). The primary class represents more than 80% of the total assets across all share classes.

[5]There are 24,050 equity funds with a TNA of $10.2 trillion in Lipper if we exclude closed-end and funds-of-funds. In this case our initial sample covers 82% of the TNA of equity funds worldwide. The EFAMA statistics are not entirely consistent across countries whether or not they include these type of funds.

style: domestic funds (i.e., funds that invest in their domicile country) and international funds (i.e., funds that invest in countries or regions different from the one where they are domiciled, and funds that invest globally). We require a country to have more than ten funds to be included in the sample. The final sample covers 8,176 domestic funds and 8,140 international funds. Table A.1 in the Appendix lists the top three domestic and international funds by TNA in each country as of 2007.

Table 1 presents the number and TNA of the sample of mutual funds by country as of 2007. TNA is given by the sum of all share classes when there are multiple share classes. There are a total of 12,577 equity funds in the sample in 2007, managing $6.7 trillion of assets. U.S. funds represent 67% of the sample in terms of TNA, but only 22% of the total number of funds. Other countries with a large number of funds are Australia and Canada, which account for 17% and 12% of the total number of funds.

A country's weight in terms of number of funds is greater than its weight in terms of fund size for all countries except the U.S., indicating that on average non-U.S. mutual funds are much smaller than U.S. funds. The average fund in Europe is five times smaller than the average U.S. fund. This is also the case in Asia, where the average fund is nearly 17 times smaller than in the U.S. Overall, non-U.S. funds are more than seven times smaller than U.S. funds.

Table 1 also divides funds by geographic investment style. Domestic funds represent about half of the sample in terms of the number of funds and 63% in terms of TNA. Domestic funds are, on average, 1.6 times larger than international funds. The U.S. mutual fund industry is heavily weighted toward domestic funds, as they account for more than 80% of the number of the funds and more than 70% of the TNA in the U.S. International funds, however are dominant in other countries like Australia, Canada, France, Germany, and the U.K.. For example, international funds in Australia, Canada, and France represent, respectively, 46%, 60%, and 76% of the number of funds and 39%, 42%, and 70% of the TNA. We conclude that U.S. investors prefer mutual funds that invest mainly in domestic

stocks, while non-U.S. investors exhibit less home bias as they invest a significant part of their stock portfolio in international funds.

2.2 Measuring Fund Performance

We estimate the mutual funds (risk-adjusted) performance using several benchmark models. Fama and French (1992) propose a three-factor model that improves average CAPM pricing errors by including size and book-to-market factors. Carhart (1997) proposes adding a factor that captures the Jegadeesh and Titman (1993) momentum anomaly. The four-factor model regression is given by:

$$R_{it} = \alpha_i + \beta_{0i} RM_t + \beta_{1i} SMB_t + \beta_{2i} HML_t + \beta_{3i} MOM_t + \varepsilon_{it}, \quad (1)$$

where R_{it} is the return in U.S. dollars of fund i in excess of the one-month U.S. Treasury-bill in month t; RM_t is the excess return in U.S. dollars on the market; SMB_t (small minus big) is the average return on the small-capitalization portfolio minus the average return on the large-capitalization portfolio; HML_t (high minus low) is the difference in return between the portfolio with high book-to-market stocks and the portfolio with low book-to-market stocks; and MOM_t (momentum) is the difference in return between the portfolio with the past-12-month winners and the portfolio with the past-12-month losers.

The benchmark model in equation (1) nests several alternative benchmark models. The market model assumes $\beta_{1i} = \beta_{2i} = \beta_{3i} = 0$ and market-adjusted returns further assume that $\beta_{0i} = 1$.We also use benchmark-adjusted returns by taking the difference between the fund return and its benchmark return as listed on Lipper. We present results using these alternatives in the robustness section.

We construct the monthly benchmark factors for each individual country using all stocks included in the Datastream/Worldscope database. The market return RM is computed using the value-weighted average return in U.S. dollars of all stocks in each country in each month.

To form the size and book-to-market equity portfolios, we follow the procedure described in Fama and French (1992). For each country, the SMB and HML factors from July of year t through June of year $t+1$ are calculated using six value-weighted portfolios formed at the end of June of year t on the intersection of two size portfolios (market equity capitalization, ME) and three book-to-market equity (BE/ME) portfolios. The size breakpoint is the median market capitalization of each country as of the end of June of year t. Half of the firms are classified as small market capitalization and the other half as big market capitalization. For the BE/ME classification, the breakpoints are the 30th and 70th percentiles of BE/ME in each country for the fiscal year end in $t-1$. The bottom 30% is designated as the value portfolio, the middle 40% as the neutral portfolio, and the highest 30% as the growth portfolio.

The SMB factor is the monthly average return of the three small portfolios minus the average return of the three big portfolios:

$$\begin{aligned} SMB \;\; = \;\; & (Small\ Value + Small\ Neutral + Small\ Growth \\ & -Big\ Value - Big\ Neutral\ - Big\ Growth)/3. \end{aligned} \tag{2}$$

The HML factor is the monthly average return of the two value portfolios minus the monthly average return of the two growth portfolios:

$$HML = (Small\ Value + Big\ Value - Small\ Growth - Big\ Growth)/2. \tag{3}$$

Table A.2 in the Appendix presents the average and standard deviation of the benchmark factors by country.

The momentum factor (MOM) for month t is calculated using six value-weighted portfolios formed at the end of month $t-1$, as a result of the intersections of two portfolios formed on size (ME) and three portfolios formed on prior (2-12) month returns. The ME breakpoint is the median market equity in each country as of the end of month $t-1$. For the

return classification, the 30th and 70th percentiles of the prior returns (2-12) in each country are the breakpoints. The bottom 30% are designated as the down month prior return portfolio, the middle 40% as medium, and the highest 30% as up. The MOM factor is the monthly average return on the two high-prior return portfolios minus the monthly average return on the two low-prior return portfolios:

$$MOM = (Small\ High + Big\ High - Small\ Low\ - Big\ Low)/2. \tag{4}$$

We use monthly fund returns (net of expenses) denominated in U.S. dollars from July 1997 through December 2007 to estimate the factor models.[6] We also present results using gross returns in the robustness analysis. First, we estimate the time series regression of the monthly fund excess returns on the factor portfolios' returns using the previous 36 months of data, every quarter (we require a minimum of 24 months of return data).[7] We then subtract the expected return from the realized fund return to estimate the fund abnormal return in each quarter, or alpha, which is measured as a sum of an intercept of the model and the residual as in Carhart (1997). Alpha measures the manager's contribution to performance due to stock selection or market timing. A positive (negative) alpha indicates that the fund overperforms (underperforms) the benchmark. Since we use three years of return data to estimate the factor model, our first estimate of a fund's alpha is for the first quarter of 2000.

Table 2 presents the average factor loadings for domestic funds by country and the associated R^2 statistics from these regressions. We see that U.S. funds, on average, load more on SMB, HML and MOM than non-U.S. funds. So, U.S. funds play more small, value, and momentum stocks than non-U.S. funds.[8] It is well known that the four factor model works well in explaining the variation in U.S. mutual fund performance and our finding of

[6] Our primary findings are not affected when we use fund returns in local currency.

[7] There is look-ahead bias in our sample due to the exclusion of new funds that do not have enough history for the regression analysis (see Brown, Goetzmann, Ibbotson, and Ross (1992)).

[8] The comparatively high loading on SMB for U.S. mutual funds might be explained by the historically poor performance of the size factor outside the U.S. Indeed, across the countries in our sample the average fund loadings on SMB across countries appear to line up with the magnitude of the average size premia.

an average R^2 statistic for U.S. funds of 85% bears this out. Even though the four-factor model was developed on U.S. data, its R^2 outside the U.S. is even higher, at 88%. This reassures us that the 4-factor model is an appropriate way to evaluate fund performance for our worldwide sample.

2.3 Fund Characteristics

Table 3 reports averages of mutual fund returns and alphas for domestic funds by country. We winsorize returns and alphas at the bottom and top 1% level. The average fund return is 3.01% per quarter. We report average Carhart four-factor alphas. The fund alphas are negative for about half of the countries. The countries with the best performance are Denmark, Thailand, and Portugal, while the countries with the worst performance are Norway, Australia, and France. U.S. funds are in the middle of the pack with an average alpha of -0.30% per quarter, which is consistent with the average alpha in Chen et al. (2004) for U.S. funds. Thus, there is evidence of underperformance in the worldwide mutual fund industry. The average alpha is -0.20% per quarter with a standard deviation of 4.18%. Overall, the figures here are consistent with other studies that find that fund managers do not have the ability to beat the market (or stay even with it) after fees (e.g., Malkiel (1995), Gruber (1996)).

Table 3 also presents average fund characteristics by country. We winsorize the expense ratio, total loads, and flows at the bottom and top 1% level. Panel A of Table A.3 in the Appendix defines fund-level variables.

Fund size is measured by total net assets (TNA) in U.S. dollars. The U.S., the U.K., and Germany have the largest funds, while Thailand and South Korea have the smallest funds. U.S. funds have an average TNA of $949 million, followed by the U.K. with $471 million and Germany with $418 million. Overall, the average TNA in our sample of funds is $558 million. Outside the U.S., the average TNA of funds is only $170 million.

We also examine the effect on performance of the size of a fund's family. Family size is

measured as the sum of all equity funds under management by a particular company. We use the parent management company to calculate total equity assets under management. In the case of transnational fund companies we use the sum of all equity assets worldwide. Funds domiciled in the U.S., the U.K., Japan, Germany, Australia, and Canada are managed by the largest fund families. Interestingly, the average family fund size of funds domiciled in Poland and Taiwan is also quite high, despite low individual fund size. This happens because funds in these two countries are part of large global fund families.

We use a host of other fund characteristics in our analysis of performance. The first characteristic is fund age as given by the fund launch date. The average fund age is about 11 years. Funds domiciled in Germany, Switzerland, the U.K., and the U.S. tend to be among the older ones. U.S. funds have an average age of 12.6 years.

The second characteristic is the total expense ratio, defined as total annual expenses as a fraction of TNA. In some countries where the expense ratio is not available we use the management fee. The average expense ratio is 1.46%. Expenses vary considerably across countries despite the global nature of the mutual fund industry. For example, average expense ratios are the lowest in Belgium (1.05%) and the Netherlands (1.08%), while they reach maximums of 3.25% in Poland and 2.68% in South Korea. U.S. funds present an average expense ratio of 1.30%, which is slightly higher than the ratio reported in other studies. The third characteristic is total loads defined as the sum of front-end and back-end loads. The average total load is 2.65%. Loads vary considerably across countries, U.S. funds present total loads similar to the overall average.

The fourth characteristic of interest is flows defined as the percentage growth in total assets under management (in local currency) between the beginning and the end of quarter t, net of internal growth (assuming reinvestment of dividends and distributions):

$$Flow_{it} = \frac{TNA_{it} - TNA_{i,t-1}(1 + R_{it})}{TNA_{i,t-1}} \tag{5}$$

where TNA_i is total net assets in local currency of fund i, and R_t is fund i return in local currency. Funds have an average flow of 0.44% per quarter. The flows are positive in the majority of the countries (exceptions include, for example, Germany, Italy, Japan, and Switzerland).

The fifth characteristic is the number of countries where a fund is sold. This variable tells us where fund investors are located. While in some countries like the U.S., funds are distributed only locally, in Europe it is common for a fund to be sold in more than in one country. The average number of countries where a fund is sold is 1.1 for domestic funds, but we can find some countries where it is common that a fund is sold in several countries (e.g., Austria, Belgium, Germany, Sweden, and the U.K.).

Finally, we consider management structure as a potential determinant of fund performance. Lipper provides a field listing names of managers in charge of a fund. We use a dummy variable (management team) that takes a value of one if the number of managers is greater than one or the fund is listed as team-managed or by the name of the management company, and zero if the fund is managed by a single manager. This variable identifies the organizational structure influencing the decision-making process of the fund, and it may help to explain fund performance. Funds tend to be managed by teams in countries such as Australia, Canada, France, and Japan. Management by teams is less common in Germany and the U.K.. In the U.S., 63% of the funds are managed by teams (or more than one person), which is consistent with figure reported in Massa, Reuter, and Zitzewitz (2010). Overall, 68% of the funds are managed by teams (or more than one person).

2.4 Country Characteristics

Our sample of equity mutual funds includes 27 countries. This large cross-section of countries allows us to examine the role of the fund's domicile country characteristics in explaining fund performance. To our knowledge, this feature is unique to our study of mutual fund performance around the world. We use several country-level variables as explanatory variables

that are classified into five groups: economic development; financial development; investor protection and quality of legal institutions; mutual fund industry development and concentration. Table 4 reports averages for the country-level variables. Panel B of Table A.3 in Appendix presents the country-level variables definitions.

We use gross domestic product per capita (GDP per capita) in U.S. dollars from the World Development Indicators (WDI) database as a measure of economic development. An additional measure of economic development is the ratio between number of internet users and the population of a particular country, taken from WDI. The intensity of internet usage is likely to be higher in countries with better informed investors and more sophisticated investors.

We use two proxies for level of stock market development and liquidity. First, the share turnover ratio, defined as the ratio of total value of stocks traded to market capitalization. This variable is from the WDI database. The second variable is country-level trading costs in basis points. We use the annual average transaction cost (including commissions, fees, and price impact) from the Global Universe Data-ElkinsMcSherry database. Countries with less developed markets are countries with higher trading costs (Malaysia, India, Thailand, South Korea, and Taiwan), while more developed markets like the U.S. and Japan have lower trading costs.

We consider three variables to proxy for investor protection and quality of legal institutions. The first proxy for investor protection is a dummy variable that equals one if the legal origin is common law, and zero if the legal origin is civil law. Common law systems provide better legal protection to investors than civil law systems (see La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1997)). In our sample we have nine countries with common law legal origin (Australia, Canada, India, Ireland, Malaysia, Singapore, Thailand, the U.K., and the U.S.). The second proxy is an index of minority shareholder protection (anti-director rights) from Djankov, Porta, Lopez-de-Silanes, and Shleifer (2008). The final variable is securities regulation, the combination of disclosure requirements, liability standards, and public

enforcement from La Porta, Lopez-de-Silanes, and Shleifer (2006).

Finally, we use variables to proxy for the level of a country's mutual fund industry development and concentration. The level of development of the mutual fund industry is proxied by the age of industry measured in number of years since the first open-end fund was sold in the country as reported in Khorana et al. (2005). To measure industry concentration we use the Herfindahl Index, defined as the sum of the squared market shares of portfolio management companies for equity funds in each country. The Herfindahl Index is a common indicator of the level of concentration within an industry. Higher values of the Herfindahl Index indicate higher industry concentration. Concentration is higher in Indonesia, Portugal, and Belgium, and lower in the U.K., Australia, Canada, France, and the U.S. We also use the relative mutual fund industry size as proxied by equity assets under management scaled by stock market capitalization (mutual fund equity/market capitalization) per country as an additional explanatory variable. The data on equity assets under management are obtained from EFAMA and stock market capitalizations are obtained from WDI.

3. Determinants of Fund Performance

We investigate the determinants of equity mutual fund performance. Following the large majority of the mutual fund literature, we focus the analysis on domestic mutual funds, but we also use international funds in some tests. We run separate regressions using U.S. and non-U.S. funds that allow us to compare the determinants of the performance of funds in the U.S. versus the rest of the world. All the regressions include time fixed effects (quarter dummies) to account for cross-sectional dependence, and t-statistics are clustered at the fund level to account for autocorrelation in fund performance. All explanatory variables are lagged one-quarter.

3.1 Fund Characteristics

Table 5 reports results of performance regressions using the Carhart four-factor model alphas as a measure of risk-adjusted performance. Later, we use alternative measures of performance. Column (1) presents estimates for U.S. funds. Column (2) presents estimates for non-U.S. funds using fund characteristics and country dummies as regressors. Columns (3)-(6) present estimates for non-U.S. funds using fund and country characteristics as regressors. We first discuss the effects of fund characteristics and then of country characteristics.

Fund Size. Mutual fund size has been one of the most studied variables in mutual fund research, and the relation between fund size and performance still puzzles academics and practitioners. Several studies try to answer questions such as: Does fund size affect investors' fund selection ability? Is management skill more pronounced when a fund is small?

Large mutual funds present several advantages over small ones. First, larger funds are able to spread fixed expenses over a larger asset base, and have more resources for research. Managers of large funds can benefit from investment opportunities not available to smaller funds. Large funds are able to negotiate better spreads, as they have larger positions and trading volumes. Furthermore, brokerage commissions decline with the size of transactions (Brennan and Hughes (1991)).

Large funds, however, face some problems and management challenges, and the scaleability of investments is a determinant of performance persistence (Gruber (1996) and Berk and Green (2004)). While small funds can concentrate on a few investment positions, when funds become large managers must continue to find good investment opportunities, and the effect of managerial skill becomes diluted (diseconomies of scale). Cremers and Petajisto (2009) show that small funds are more active, while a significant fraction of large active funds are close to index funds. Moreover, larger mutual fund managers must necessarily trade larger volumes of stock, attracting the attention of other market participants and therefore suffering higher price impact costs. Chen et al. (2004) name this effect the liquidity

constraints hypothesis.

Grinblatt and Titman (1989) and Grinblatt and Titman (1994) find mixed evidence on the relationship between fund returns and fund size. More recently, Chen et al. (2004) find that fund returns decline with lagged fund size. The results is most pronounced among funds that invest in small and illiquid stocks, suggesting that adverse scale effects are related to liquidity. They also suggest that in addition to liquidity, fund size erodes performance because of organizational diseconomies. Pollet and Wilson (2008) find that the cause of diminishing returns to scale for mutual funds is the inability to scale an investment strategy related to liquidity constraints as the fund grows. They find that when a fund receives inflows it tends to scale up its positions instead of diversifying into new assets. Edelen, Evans, and Kadlec (2007) and Yan (2008) point out trading costs and liquidity as the primary source of diseconomies of scale for U.S. funds. Outside the U.S., Dahlquist et al. (2000) find that larger equity funds tend to perform more poorly than smaller equity funds in Sweden. Overall, evidence on the size-performance relation is not unanimous, but recent work seems to support the presence of diseconomies of scale.

Column (1) of Table 5 shows that fund size (TNA) is negatively related to fund performance in the sample of U.S. funds. The TNA coefficient is negative and significant for U.S. funds, -0.0675 with a t-statistic of -4.99. Thus, U.S. smaller funds perform better than larger funds. Since the standard deviation of TNA (log) is 2.20, a one-standard deviation increase to fund size is associated with a decline in performance of 15 basis points per quarter (60 basis points per year). These effects are economically significant if we take into consideration the average fund performance is near zero. This estimate of the diseconomies of scale to U.S. funds is very close to the one reported in Chen et al. (2004).

There are reasons to believe that the result might be different outside the U.S., because of the difference in size between U.S. funds and non-U.S. Indeed, the average fund is much bigger in the U.S. than outside the U.S., as we have documented earlier. The results in column (2) support a very different relation between performance and TNA for non-U.S. funds.

Fund size has a positive and significant effect (the coefficient is 0.0517 with a t-statistic of 4.58) on performance in the sample of non-U.S. funds. A one-standard deviation increase in fund size is associated with an increase in abnormal performance of 11 basis points per quarter (44 basis points per year). Larger non-U.S. funds seem to have better risk-adjusted performance than smaller funds. We further explore the reasons behind this asymmetry on the relation between fund performance and size in the next subsection. In particular, we test the hypothesis that economies of scale are exhausted after a fund approaches a certain size in fund assets, as U.S. funds are much bigger than non-U.S. funds.

Fund Family Size. Economies of scale and scope can exist at the fund family level. Expenses like research and administrative expenses can be shared among funds. Larger fund families can use the same economic data and experts to interpret data across many funds, leading to economies of scope and higher returns. Large fund families also benefit from economies of scale from trading commissions and lending fees (Chen et al. (2004)). Khorana and Servaes (1999) in studying mutual fund starts find that large families and families that have more experience in opening funds in the past are more likely to open new funds. This is likely to happen because the cost of generating a new fund is lower for large companies, as they can benefit from economies of scale and scope. Chen et al. (2004) find that fund family size has a positive and statistically significant effect on performance, which they ascribe to family size capturing economies of scale.[9]

We find that fund family size has a positive and significant effect on performance in the U.S. and elsewhere in the world (see Table 5). Funds that perform better are more likely to be managed by a larger company as family size has a positive effect on fund abnormal performance. The effect of family size is statistically and economically significant, and it is of similar magnitude in the U.S. and outside the U.S. Since the standard deviation of family TNA (log) is 2.51, a one-standard deviation increase in family size is associated with an

[9] Others suggest that larger families transfer performance from low-fee funds to high-fee funds, and they are committed to create stars that generate inflows to the fund itself and to other funds in the family at the expense of more poorly performing funds (Nanda, Wang, and Zheng (2004) and Gaspar, Massa, and Matos (2006)).

improvement in performance of 8 basis points per quarter (32 basis points per year). This estimate of the economies of scale in fund families is similar to the one reported in Chen et al. (2004) for U.S. funds. We conclude that the positive effect of family size on performance is pervasive around the world.

Age. Fund age provides a measure of a fund's longevity and its manager's ability. The effect of age on performance can run in both directions. One might argue that younger mutual funds will be more agile and committed to achieve better performance to survive. On the other hand, youth may be a disadvantage, newer funds usually face higher costs and suffer from lack of experience during the start-up period. Because of their small size, newer mutual funds' returns and ratings are also more vulnerable to manipulation. We find no relation between age and performance of U.S. mutual funds in column (1), which is consistent with the evidence in Chen et al. (2004) and others. In contrast, we find that newer funds seem to perform better than older funds outside the U.S. Using the point estimate in column (2), a one-standard deviation increase in fund age (log) is associated with a drop in performance of 6 basis points per quarter (24 basis points per year) of non-U.S. funds.

Expenses. The relation between mutual fund returns and expenses (including management fees) provides a test of the value of active management. Mutual fund fees can be seen as the price that uninformed investors pay to managers to invest their money. Expenses vary considerably around the world. Khorana et al. (2009) find that large funds and families charge lower fees, while funds distributed in more countries charge higher fees. Furthermore, they find that fees are negatively related to investor protection. Empirical evidence on the relation between mutual fund performance and fees is mixed. In a sample of U.S. mutual funds, some authors find a negative relation of fees with net-fee performance (Carhart (1997)) and even before-fee performance (Gil-Bazo and Ruiz-Verdu (2009)), while others find no relationship between fees and performance (Chen et al. (2004)). Evidence for European funds also seems to support a negative relation between fees and performance (Dahlquist et al. (2000) and Otten and Bams (2002)). We find a negative relation between the expense ratio and

net-of-fees performance. This relation, however, is statistically insignificant for U.S. funds and only significant in some specifications for non-U.S. funds. Thus, there is not consistent evidence of a statistically significant negative relation between fees and performance.

Loads. Besides the expense ratio, funds commonly charge a load when investors purchase (front-end load) or sell (back-end load) shares of the fund. The main goal of the back-end load is to discourage redemptions. By making redemptions expensive, a mutual fund dissuades investors from redeeming shares, and it is able to invest in a more risky portfolio to enhance performance. The empirical evidence confirms that loads do dissuade redemptions in open-ended funds, and that funds hold more cash when there is uncertainty about redemptions (Chordia (1996)). Authors find no relation between performance and loads (Chen et al. (2004)) or a negative relation (Carhart (1997) and Pollet and Wilson (2008)). We do not find a statistically significant relation between performance and loads in our sample of U.S. and non-U.S. funds.

Flows. According to the "smart money" hypothesis of Gruber (1996), investors can detect skilled managers and direct their money to them. Therefore, fund flows should have a positive correlation with future returns. Gruber (1996) and Zheng (1999) show that funds experiencing net inflows (in the last three months) perform significantly better than funds that experience outflows. However, Sapp and Tiwari (2004) argue that the "smart money" effect is explained by momentum. We find no evidence of a significant relation between flows and subsequent performance in the sample of U.S. funds. Since we are using the Carhart model to measure performance, this is consistent with the Sapp and Tiwari (2004) argument. In contrast, we find that non-U.S. funds that receive more new money perform better subsequently than those that receive less new money. Flows of the previous period have a positive and significant coefficient, indicating a "smart money" effect. Using the specification in column (2), a one-standard deviation increase in flows is associated with an improvement in subsequent performance of 20 basis points per quarter (80 basis points per year). The evidence here supports the idea that investors are able to detect skilled fund

managers outside the U.S.

How robust are our smart money findings outside the U.S.? First, it should be recognised that as our performance measures are momentum adjusted in our smart money regressions that these results are not attributable to stock-level momentum. Second, it might be argued that serial correlation in flows might inflate our t-statistics on lagged flows thereby biasing us towards accepting the existence of smart money outside the U.S. Ferson, Sarkissian, and Simin (2003) show that autocorrelation in independent variables in return regressions may lead to spurious inference when levels of first order autocorrelation in the independent variables are above 90% and when the R^2 statistics in the regressions are less than 1%. For our non-U.S. sample of funds, the average first order autocorrelation of flows across funds is 0.25. In addition, the goodness of fit statistics for our non-U.S. performance regressions in Table 5 are approximately 5%. Adding these findings to the fact that the t-statistics on lagged flows in our performance regressions are extremely high (between 8.5 and 10) this suggests that the incorrect inference problem suggested by Ferson et al. (2003) may not be a problem in our dataset. Our subsequent smart money results using the Fama-MacBeth approach for the non-U.S. sample below also add credence to this. As the time dimension is essentially removed when using this technique, our findings that we still have smart money effect outside the U.S. when using approach suggest that our smart money findings are not due to the persistence of flows. Third, as we are controlling for lagged performance in these smart money regressions, differences in performance persistence across countries do not account for our findings.

Past Performance. There is ample evidence of performance persistence in U.S. mutual funds (Hendricks et al. (1993), Grinblatt and Titman (1994), Brown and Goetzmann (1995), and Carhart (1997)). This persistence seems to be stronger among the most poorly performing funds. Outside the U.S., Dahlquist et al. (2000) do not find performance persistence for a sample of Swedish funds, and Otten and Bams (2002) find performance persistence only for U.K. funds. We find evidence of persistence in U.S. funds. The effect of past performance

on future performance of U.S. funds is economically meaningful. A one-standard deviation increase in past performance is associated with an increase in subsequent performance of 27 basis points per quarter in the sample of U.S. funds. Outside the U.S., persistence seems to be much weaker or even inexistent (the coefficient is insignificant in column (2) when the regression includes country dummies).

Management Structure. While individual managers are free from group politics difficulties, teams of decision-makers have more resources and connections, which can help to boost performance. Accordingly, funds managed by a team might perform better than funds managed by an individual manager. On the other hand, small funds can easily be run by a single manager, while a large fund usually cannot. Chen et al. (2004) suggest that larger funds experience organizational diseconomies, especially hierarchy costs, as funds deal mainly in soft-information. When a fund is co-managed, there is more competition to implement an idea and managers may end up expending too much effort to convince others to implement their ideas than they would if they controlled their own funds (Aghion and Tirole (1997) and Stein (2002)). Chen et al. (2004) provide some evidence that size erodes fund performance because of the interaction of liquidity and organizational diseconomies of scale. While team management may have become increasingly popular in the mutual fund industry, U.S. evidence shows that team-managed funds perform either no differently from (Bliss, Potter, and Schwarz (2008)) or more poorly (Chen et al. (2004) and Massa et al. (2010)) than funds managed by a single manager. We find that funds managed by teams (or more than one individual) show significantly worse performance than funds managed by a single person. The difference in performance is also economically significant at roughly 14 basis points for U.S. funds and 11 basis points for non-U.S. funds using the specification in column (2).

Number of Countries Where a Fund is Sold. We also analyze whether the number of countries where a fund is sold helps to predict performance. There are two main reasons why the number of countries where a fund is distributed can affect performance. First, selling

a fund in several countries should make the fund less sensitive to shocks in domestic flows. If investor flows from different countries are not perfectly correlated, distributing the fund in several countries makes the fund less cash flow volatile, reducing the cash position, and enhancing performance. Second, it is well known that top-performing funds can originate a substantial amount of inflows for a fund family (Nanda et al. (2004)). Therefore, fund families are likely to make star funds available in more countries in order to gain market share and increase revenues. We find that the coefficient of number of countries where a fund is sold is statistically insignificant for U.S. and non-U.S. funds (the effect is only significant when we include country-level variables as regressors instead of country dummies). Thus, there is weak evidence that funds distributed in several countries display better performance.

3.2 Country Characteristics

We do not know of any study so far to document the effects of country characteristics on fund performance. Our sample covering a large cross-section of countries allows estimation of the specifications using country-level variables (Table 5, columns (3)-(6)). We do not include U.S. funds in these regressions as they would represent a large fraction of the sample, but we obtain similar results when we include them.

Economic Development. Economic development is associated with higher per capita income and better education and skills, as well as with more developed industries and more incentives for innovation and for new investments. Better financially educated and more sophisticated investors are likely to evaluate fund performance and follow it more closely, exerting some pressure on management for performance. Furthermore, managers are likely to be more skilled in more developed countries, as populations are better educated and have access to more learning opportunities. Developed countries also tend to attract high human capital individuals. Christoffersen and Sarkissian (2009) find that managers located in financial centers in the U.S. display better performance. Therefore, a country's level of economic development might influence the performance of the mutual fund industry. We

find no evidence that a country's level of economic development as measured by GDP per capita is positively linked to fund performance. The relation is even negative and significant sometimes. We conclude that broad economic development is not positively associated with the performance of domestic mutual funds once we control for other aspects of a country's level of development. In contrast, we find that the intensity of internet usage has a positive and significant coefficient. This finding is consistent with the idea that funds display better performance in countries where investors are better informed and better educated and money managers have better skills and greater access to learning opportunities.

Financial Development. A more developed financial market can have some advantages for fund performance because of higher liquidity and lower transaction costs. Trading costs are important in evaluating fund performance as they provide valuable information about the extent of deterioration in performance from active trading. Clearly, actively managed funds involve substantially higher trading costs (Keim and Madhavan (1997)), and trading costs are also related to fund size. As funds become larger, they will necessarily trade larger volumes. Khorana et al. (2005) find that trading costs have a negative impact on the development of the mutual funds industry. We find strong evidence of a positive relation between trading activity and fund performance and a negative relation between trading costs and fund performance. A one-standard deviation increase in share turnover is associated with an improvement in performance of 38 basis points per quarter, while a one-standard deviation reduction in trading costs is associated with an improvement in performance of 26 basis points per quarter. Thus, the evidence indicates that the liquidity of the local stock market plays a prominent role in improving the performance of funds that invest in local stocks.

Investor Protection and Quality of Legal Institutions. Differences in laws and regulations can affect investor behavior. Investors will be reluctant to invest in markets where their rights are not properly protected. La Porta et al. (1997) note that countries with poor investor protection have significantly smaller debt and equity markets. They also observe

that the quality of the legal system is important for the enforcement of contracts and also captures the government's general attitude toward business. Accordingly, we expect to find that mutual fund performance is positively related to investor protection and the quality of a country's legal institutions. We use three different variables to proxy for investor protection and the quality of legal institutions. We first use a country's legal origin, which has been linked to the quality of legal institutions and investor protection. The common law dummy variable has a positive and significant coefficient in column (3). Thus, there is evidence that domestic mutual funds perform better when investor protection is stronger. The effect of legal origin is economically strong. Funds domiciled in countries with a common law legal origin outperform funds domiciled in countries with civil legal origin by 63 basis points per quarter. In columns (4)-(6), we use the anti-director rights index and the securities regulation index to capture other aspects of a country's legal environment such as protection of minority shareholder interests and the quality of securities market regulations. In every case, we find evidence of a positive effect on fund performance. For example, an increase in the number of shareholder protection mechanisms from three to five enhances fund performance by approximately 60 basis points per quarter.

Mutual Fund Industry Development and Concentration. Mutual funds have been one of the fastest growing types of financial intermediary. This is a relatively recent trend in a significant number of countries vis-à-vis the U.S. The older the industry, the greater the investors' experience, and the more investment there will be in mutual funds (Khorana et al. (2005)). Mutual fund managers will also be more experienced. We hypothesize that the older the industry, the more efficient the fund industry will be, and this may lead to better performance. We do not find empirical support for the hypothesis that older industries display better performance. In a competitive industry, mutual fund firms might feel pressure for their funds to perform well. One might also argue that in a more competitive industry it is harder to achieve abnormal performance. We find a positive relation between mutual fund industry concentration and the performance of domestic funds. Overall, we do not find

evidence that industry development and lack of concentration enhance the performance of domestic funds.

Finally, we take into account the size of the equity mutual fund industry relative to the pool of underlying assets (proxied by equity assets under management scaled by stock market capitalization per country). The coefficient on the relative mutual fund industry size (mutual fund equity/market capitalization) is negative and significant. This is consistent with the notion that in countries where the relative equity mutual fund industry size is greater there are fewer unexploited arbitrage opportunities. It is worth noting that the coefficient on lagged fund TNA remains positive and significant for non-U.S. funds after controlling for relative equity mutual fund industry size. This indicates that a less competitive capital allocation in the mutual fund industry is not responsible for the lack of diminishing returns to scale outside of the U.S.

What do these findings tell us about how fund growth affects fund performance outside the U.S.? When funds increase in size, the impact of that growth on their performance depends on a fund-level and an industry-level effect. If funds grow at the expense of their rivals so that relative industry size is unchanged, we need only worry about the fund-level effect. The coefficient on individual fund size tells us that growth is likely to lead to improved performance for small funds, and unlikely to do so for larger ones. However, if funds grow by bringing new money into the fund sector, thus increasing relative fund industry size, then the industry-level effect will also come into play. In this case, the impact of their growth on performance will depend on the relative magnitudes of the diminished arbitrage opportunities (the industry-level effect) versus the potential cost reductions from being a larger fund (the fund-level effect).

In summary, our research suggests that mutual fund performance is related to both fund and country characteristics. There is evidence that funds from larger fund families and solo-managed funds have higher risk-adjusted returns around the world. These findings are consistent with the evidence for U.S. funds. There are, however, important distinctions

between the determinants of performance in the U.S. and elsewhere in the world. There is evidence of diseconomies of scale only in the U.S., while there is evidence of economies of scale outside the U.S. We find that the "smart money" effect is only present outside the U.S., while performance persistence is a characteristic specific the U.S. fund industry. In terms of country characteristics, local stock market liquidity, investor protection and law enforcement, and industry concentration have a positive effect on the performance of funds that invest in local stocks.

3.3 Why Are There Diseconomies of Scale in the U.S. Mutual Fund Industry?

We have documented the existence of diseconomies of scale in the U.S. mutual fund industry, while there is evidence of economies of scale outside the U.S. In this section, we aim to understand the reasons behind this asymmetry. We leave other differences in terms of return persistence and "smart money" effect for future research.

We test two main hypothesis to explain the asymmetry in the relation between performance and size between U.S. and non-U.S. domestic funds. A first hypothesis comes from the fact that U.S. funds are much larger than elsewhere in the world (the average U.S. domestic fund is more than five times larger than the average non-U.S. domestic fund in our sample; see Table 3). The difference in size between U.S. and non-U.S. domiciled funds is striking if we look at the top 100 funds in terms of total net assets (TNA) at the end of 2007. There are only nine non-U.S. funds among the top 100 domestic funds. The largest fund in our sample is the American Growth Fund of America with a TNA of $194 billion, while the largest non-U.S. fund is the Invesco Perpetual High Income with a TNA of $19 billion and a rank of 26th.

We sort mutual funds in each quarter based on the quintile rankings of their TNA. We perform the sort not only for domestic funds, but also for international funds as we use these funds in this section to better understand the asymmetry between the U.S. and the rest of the

world in terms of the relation between fund performance and size. Table 6 presents number of funds and mean TNA for each fund size quintile separately for domestic funds (Panel A) and international funds (Panel B) and within each of these groups separately for U.S. and non-U.S. funds. Notice that the size quintile rankings are solely based on funds within each subgroup (e.g., U.S. domestic funds). In each quarter, there are on average about 400 U.S. and non-U.S. domestic funds in each fund size quintile. There is a substantial spread in TNA between the bottom and top size quintiles. Domestic funds in the bottom quintile have an average TNA of $13 million in the U.S., whereas the ones in the top quintile have an average TNA of over $4 billion. There is also a significant spread for non-U.S. domestic funds. Funds in the bottom quintile have an average TNA of $2 million and in the top quintile $726 million. We can also see that there is a dramatic difference between the average TNA of U.S. and non-U.S. funds across all quintiles. The U.S. fund size quintiles have an average TNA more than five times larger than the corresponding non-U.S. fund size quintiles. The fund size quintiles of international funds in Panel B shows no significant differences between the average TNAs of domestic and international funds in the U.S. as well as outside the U.S. Thus, domestic and international funds have comparable scale of operations.

A second hypothesis suggests that liquidity constraints play an important role in explaining the lack of scale-ability of fund investments in the U.S. mutual fund industry (Chen et al. (2004) and Pollet and Wilson (2008)). This hypothesis is supported by the fact that large U.S. domestic funds that have to invest, by virtue of their style, in small (and illiquid) stocks are the most affected by scale, and the inability to scale an investment strategy as the fund grows due liquidity constraints. This hypothesis is consistent with the arguments of Berk and Green (2004) that small funds can concentrate on a few investment positions, but when funds become large managers must continue to find good investment opportunities, and the effect of managerial skill becomes diluted. We have documented that U.S. domestic funds play more small (and illiquid) stock than funds located elsewhere in the world (see Table 2). This could contributes to hurt performance as the scale of the fund increases. Thus, liquidity

constraints are put forward as a plausible explanation to the different relation between fund performance and size in the U.S. and outside the U.S.

Table 7 presents the results of the regression tests similar to the ones in Table 5 but designed to test our hypotheses. We focus the analysis on the fund size coefficient, but the regressions in Table 7 include the explanatory variables (coefficients not shown) used in Table 5. In columns (1)-(5) we test the hypothesis that the asymmetry is explained by the fact that U.S. funds are much larger than non-U.S. funds. In columns (6) and (7) we test the liquidity constraints hypothesis. Finally, in columns (8)-(9) we use the sample of international funds as an experimental ground to test the hypotheses.

Columns (1) and (2) present the results for the samples of U.S. and non-U.S. domestic funds excluding funds in the bottom fund size quintile. Therefore, we focus the analysis in the subsamples of funds in fund size quintiles two through five. This subsample addresses the concern that there is a systematic upward bias in the reported returns of small funds (e.g., Elton, Gruber, and Blake (2001)). This bias is potentially problematic for the analysis of the relation between size and performance, especially given the U.S. evidence of diseconomies of scale. In column (1) the coefficient on TNA is negative and significant in the sample of U.S. funds, which is consistent with the evidence for the sample of all funds. In column (2) we can see that the positive relation between fund performance and size outside the U.S. is explained by the funds in the bottom fund size quintile. Indeed, there is an insignificant relation between fund performance and size when we exclude the non-U.S. funds in the bottom size quintile. It is important to note that even in this case we do not find evidence of diminishing returns to scale outside the U.S.

Columns (3)-(5) present results for the sample of U.S. domestic funds excluding the largest funds. The goal is to evaluate the relation between performance and size for a sample of U.S. funds that is comparable with non-U.S. funds in terms of size. We perform this test using three alternative procedures. In column (3) we estimate the performance regression using a subsample that excludes the funds in the top fund size quintile (i.e., subsample of funds in

size quintiles one through four). In column (4) we estimate the performance regression using a subsample that excludes funds in the top fund size quintile but with the TNA breakpoint given by non-U.S. funds (i.e., subsample of funds with TNA below the TNA of the non-U.S. funds in the top fund quintile). In column (5) we restrict the sample of U.S. funds to only contain funds with TNA below the TNA of the largest non-U.S. fund in each quarter. The results in columns (3)-(5) still show evidence of diseconomies of scale in the U.S. fund industry. Thus, the evidence does not support the hypothesis that diseconomies of scale are driven by the fact that U.S. funds are much larger than their non-U.S. counterparts.

In columns (6) and (7) we directly test the liquidity constraints hypothesis. We identify funds in our sample that invest more in large stocks (large cap fund) and funds that invest more in small stocks (small cap funds). We define a large cap fund dummy that takes the value of one if a fund is below the median SMB factor loading, and takes the value of zero if a fund is above the median SMB factor loading in each quarter. We define this dummy separately for U.S. and non-U.S. funds. We augment the regressions specification by including the large cap fund dummy and an interaction term (TNA $\times$ Large cap fund) that measures the difference between large cap and small cap funds in terms of the relation between performance and TNA. The liquidity hypothesis predicts the sign of the interaction term to be positive since in large cap funds there should be less of an adverse effect of fund size on performance than in small cap funds. The results in column (6) for U.S. funds support this hypothesis as the interaction term is positive and significant. The TNA coefficient, which registers the effect of size on performance for small cap funds, is negative and significant. In column (7) we can see that there is not similar evidence in the sample of non-U.S. funds. The interaction term is insignificant for non-U.S. funds as they load less in small stocks and therefore they are not as affected by liquidity constraints when they grow. We conclude that the evidence from our worldwide sample of funds supports the liquidity constraints hypothesis, which is consistent with the U.S. evidence in Chen et al. (2004).

It could be argued that the liquidity of U.S. small stocks might not be that low particularly

when compared to the liquidity of the average stock from less liquid stock markets. How does the liquidity of U.S. small stocks compare to average stock liquidity across the countries in our sample? We address this question using two commonly used measures of liquidity namely effective spreads and share turnover.

The Securities and Exchange Commission (2001) (SEC) stock exchange liquidity report presents effective trading spreads for small-cap stocks that trade on the NYSE and Nasdaq (defined to have a market capitalization of less than $200 million) using data from June 2000 (the start of our sample period).[10] The study reports that small-cap stocks have effective trading spreads of 0.85% for NYSE stocks and 1.67% for Nasdaq stocks. Jain (2003) presents statistics on effective trading spreads on stock markets around the world estimated at approximately the same time in 2000. Based on these figures, in our sample of countries, 15 countries have lower average effective trading spreads than U.S. small stocks traded on the NYSE and 26 countries have average effective trading spreads lower than U.S. small stocks traded on the Nasdaq. The countries with the higher average liquidity than U.S. small cap stocks also turn out to be the countries with the largest fund management industries. Even if we take the NYSE alone as our U.S. small stock liquidity benchmark, it turns out that 88% of fund assets under management (based on Table 1) outside the U.S. come from countries where average liquidity is higher than U.S. small stock liquidity, which is explained by the fact that the largest fund industries outside the U.S. are also the most liquid.

As a cross-check we also compare the share turnover per country used in our regressions with the share turnover of U.S. small stocks. We again define "a small stock" as having a market capitalization of less than $200 million following the SEC definition above. Using CRSP share volume data, the average share turnover for U.S. small stocks during our sample period (2000-2007) is 94% per year. Comparing this figure with our share turnover figures

[10] Effective trading spreads are often argued to be more relevant than liquidity measures calculated from quotes as they measure liquidity by calculating how far away transaction prices are from quoted mid-point prices.

for other countries in Table 4, we find that 12 countries have average share turnover that is higher than that of U.S. small stocks and that these 12 countries manage the majority of assets under management outside the U.S. based on the TNA data presented in Table 1.

These liquidity comparisons suggest that a substantial number of countries in our sample have higher liquidity than U.S. small stocks. These countries account for the lion's share of assets under management of the non-U.S. mutual fund industry. Although there are some countries with lower liquidity than U.S. small stocks, these countries are the ones with the smallest mutual fund industries.

We next test the hypotheses using as a laboratory international funds. These funds face a diverse trading environment and investor clientele. In particular, liquidity constraints, which seem to be the reason for diminishing returns to scale observed in U.S. domestic funds, are likely to be less severe for international funds that can invest in a broader geographic region (or even anywhere in the world in the case of global funds). One particular acute liquidity constraint that can negatively affect fund performance is the lack of new investment opportunities. When current investment opportunities have been fully exploited, fund managers need to "go down their list" to the next-best stock (Pollet and Wilson (2008)). We argue that this constraint is less severe in international funds. Thus, we expect to find weaker evidence of diseconomies of scale (or even no relation between fund performance and size) in the sample of international funds. Furthermore, international funds can provide new insights about the hypothesis that U.S. funds are too large. U.S. international funds' average TNA is similar to the average U.S. domestic funds' TNA, and this also true across all fund size quintiles (see Table 6). If the reason behind the diminishing returns to scale in U.S. domestic funds is that they are too big, then we should also find evidence of diminishing returns to scale in U.S. international funds.

Columns (8) and (9) present the results of the international funds performance regressions for U.S.-domiciled funds and non-U.S.-domiciled funds. To examine the determinants of the performance of funds that invest overseas, we use both domestic and foreign benchmarks

(Griffin (2002)). Thus, we expand the four-factor Carhart (1997) model to include foreign SMB, HML, and MOM factors. The foreign factors are value-weighted averages of all countries's factors excluding the fund domicile country.[11]

We find that fund size is insignificantly related to performance in the sample of international U.S. funds. In the sample of non-U.S. funds, fund size is also insignificantly related to performance. This is an interesting finding since U.S. international funds size quintiles are also similar to the ones of U.S. domestic funds (see Table 6). Furthermore, there are some countries where international funds are as large as domestic funds or even larger on average (e.g., the Netherlands). We therefore again conclude that the hypothesis that diminishing returns to scale is due to the fact that U.S. domestic fund are too big is not supported by the data. U.S. international fund are as big as their domestic counterparts and they do not face diminishing returns to scale. Our findings suggest that U.S. international funds seem to face less severe liquidity constraints, as managers have more investment opportunities available as they can invest anywhere in the world. U.S. domestic funds by contrast seem to face more severe liquidity constraints as they can invest only in domestic stocks. The different relation between fund size and performance for funds with different geographic style supports the idea that liquidity constraints play an important role in explaining the diseconomies of scale in U.S. domestic mutual funds.

Our empirical findings are informative about the relevance of the Berk and Green (2004) model around the world. The central mechanism in their model is the negative feedback loop between past and future fund performance. Past performance affects fund flows as investors chase performance, which affects fund size. This change in fund size then adversely affects subsequent performance as the model assumes decreasing returns to scale. As we find that U.S. funds have decreasing returns to scale, we might expect the Berk and Green (2004) mechanism to be relevant in the U.S. context.

[11] Alternatives to an international benchmark model include world factor model (factors are aggregated across all countries), regional factors model (factors are aggregated by geographic regions), or only foreign factors model. We obtain consistent results using these variations to adjust performance for risk.

As regards the relevance of the model outside the U.S., our results demonstrate that whether the Berk and Green (2004) mechanism fails or not depends on the origins of inflows resulting from past fund performance. If inflows are the result of money being moved out of other funds, then funds will get larger individually but (relative) industry size will be unaffected. In this case, fund performance will not decline following flows and may even improve meaning that the Berk and Green (2004) mechanism will fail to work; favorable past fund performance will not adversely affect subsequent performance. However, if funds grow by bringing new money into the fund sector increasing relative fund industry size, then the impact of this on their performance will depend on the impact of fewer arbitrage opportunities (the industry-level effect) versus the potential cost reductions from being a larger fund (the fund-level effect). In this case, the relative magnitudes of these effects will determine if there are decreasing returns to scale and whether the Berk and Green (2004) mechanism will fail to work or not.

3.4 Robustness Checks

We provide several robustness checks of our main findings. Table 8 reports the results of robustness checks of the domestic funds performance regressions in Table 5. Columns (1)-(5) present the results for U.S. funds and columns (6)-(11) present the results for non-U.S. funds. We first consider several alternative models to estimate abnormal performance in columns (1) and (2) and columns (6) and (7). Here we use benchmark-adjusted returns, and alphas estimated using the market model.[12] The results are consistent with the results using the Carhart four-factor model except for the "smart money" effect in non-U.S. funds that is no longer significant. There is evidence of diseconomies of scale in U.S. funds, while the performance of non-U.S. funds does not deteriorate with the size of the fund. Family size, past performance, and number of countries sold are positively related to performance. Management by teams negatively affects fund performance.

[12]Results (untabulated) using market-adjusted returns are similar to those using market model alphas.

Columns (3) and (8) report results of tests using before-fee performance (gross returns) rather than after-fee performance. Monthly gross fund returns are calculated by adding back expenses to net fund returns; we take the annual expense ratio and divide it by 12, and add it to monthly returns during the year. The results are consistent with our primary findings except for one notable difference. The relation between fees and before-fee performance is now positive and significant, while the relation between fees and after-fee performance is negative. This suggests that higher-priced management, as measured by the expense ratio, can generate higher gross returns, but returns are not high enough to cover the fees. Our finding indicates that funds with higher fees are expected to have superior performance. Thus, we do not confirm the evidence in Gil-Bazo and Ruiz-Verdu (2009) for U.S. funds using a worldwide sample of domestic funds.

Columns (4) and (9) report results using the Fama-MacBeth estimation procedure to further address concerns on cross-sectional dependence. Columns (5) and (10) present estimates including two lags of quarterly fund flows and performance as explanatory variables to address concerns that performance and flows persistence could bias the coefficients. Finally, column (11) presents estimates with t-statistics clustered by country to address concerns that residuals are correlated within a country. Overall, the results confirm an asymmetric relation between fund size and performance between the U.S. and elsewhere in the world. There is also consistent evidence concerning return persistence and team-managed funds, while there is no evidence of a significant negative effect of fees on performance. Moreover, there is evidence of a "smart money" effect in non-U.S. funds, while this is not the case in U.S. funds. In particular, differences in performance and flows persistence between the U.S. and elsewhere in the world do not explain the differences in the "smart money" effect.

4. Conclusion

This study investigates the determinants of mutual fund performance around the world using a large sample of open-end actively managed equity funds in 27 countries over the 1997-2007 period. We find that equity mutual funds around the world underperform the market. There are common determinants of the performance of mutual funds in the U.S. and elsewhere in the world, but there are also some important differences.

The U.S. evidence of diminishing returns to scale is not an universal truth. We find that fund size is negatively related to fund performance only in the sample of U.S. funds; for non-U.S. funds, we find that fund size is associated with better performance. The asymmetry in the fund performance-size relation between U.S. and non-U.S. funds is not explained by the fact that U.S. funds are too big vis-à-vis non-U.S. funds. The evidence supports the hypothesis that liquidity constraints explain why U.S. domestic funds are affected by diminishing returns to scale. Indeed, U.S. funds that invest in small (and illiquid) stocks are the most negatively affected by scale, while this is not the case with non-U.S. funds. Moreover, the performance of international funds does not deteriorate with scale, although the scale of operations of these funds is similar to the one of domestic funds. We argue that international funds are less affected by a lack of new investment opportunities as the fund grows, as they are not restricted to invest in their local market. We conclude that diminishing returns to scale in the U.S. mutual fund industry are related to liquidity constraints faced by funds that, by virtue of their style, have to invest in small and domestic stocks.

Other fund characteristics are also important in explaining performance. The effects of the organization of the mutual fund industry on performance are pervasive around the world. Mutual funds managed by large fund families display superior performance and therefore scale is not necessarily bad for performance. Solo-managed mutual funds tend to perform better, which indicates that the possible benefits associated with team-managed funds are exceeded by the costs, in particular hierarchy costs associated with processing soft information. Additionally, we find evidence of short-run persistence in fund performance,

but only in the sample of U.S. funds. Investors outside the U.S. seem to have some ability to select funds, as money flows to funds with good future performance, but this does not hold true in the sample of U.S. funds.

Country characteristics are able to explain mutual fund performance beyond fund characteristics. There is a positive relation between mutual fund performance and a country's level of financial development, especially stock market liquidity. Furthermore, domestic funds located in countries with stronger legal institutions, better investor protection, and more rigorous law enforcement tend to perform better. We conclude that the home trading environment and the legal environment are important in explaining mutual fund performance across countries.

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Table 1
Number and Size of Mutual Funds by Country

This table presents number of funds and total net assets (TNA) under management (sum of all share classes in U.S. dollars millions) of the sample of funds by country at the end of 2007. The sample includes open-end actively managed equity funds.

Country	All Funds		Domestic Funds		International Funds	
	Number of Funds	TNA ($ million)	Number of Funds	TNA ($ million)	Number of Funds	TNA ($ million)
Australia	2,164	210,866	1,174	128,034	990	82,832
Austria	162	19,824	12	1,652	150	18,171
Belgium	184	28,917	19	3,170	165	25,746
Canada	1,491	410,546	594	237,924	897	172,623
Denmark	192	36,030	20	4,108	172	31,922
Finland	150	24,102	26	5,087	124	19,015
France	973	262,511	237	79,475	736	183,036
Germany	364	150,438	61	44,037	303	106,401
India	145	28,674	145	28,674		
Indonesia	21	2,742	21	2,742		
Ireland	79	21,606			79	21,606
Italy	274	75,783	51	14,049	223	61,734
Japan	662	69,676	430	41,586	232	28,090
Malaysia	158	6,177	158	6,177		
Netherlands	151	62,133	25	10,277	126	51,856
Norway	126	29,412	48	9,700	78	19,712
Poland	20	10,542	20	10,542		
Portugal	58	4,786	17	1,575	41	3,210
Singapore	210	17,474	12	1,513	198	15,961
South Korea	205	30,465	205	30,465		
Spain	339	31,658	91	9,371	248	22,287
Sweden	242	110,093	99	56,107	143	53,985
Switzerland	190	44,443	58	20,234	132	24,209
Taiwan	217	16,487	161	11,852	56	4,635
Thailand	125	3,035	125	3,035		
UK	934	519,649	384	277,166	550	242,484
US	2,741	4,533,223	2,216	3,216,470	525	1,316,753
Total	12,577	6,761,290	6,409	4,255,022	6,168	2,506,268
Total ex-US	9,836	2,228,067	4,193	1,038,553	5,643	1,189,515

Table 2
Mutual Fund Factor Loadings and R-squared

This table reports means of quarterly factor loadings and R^2 statistics from the Carhart four-factor model estimated with three-years of monthly fund returns (denominated in U.S. dollars). The sample includes open-end actively managed domestic equity funds. The sample period is from 2000 to 2007. RM is the excess return on the domestic market, SMB is the difference in return between the small and big portfolios, HML is the difference in return between the high and low book-to-market portfolios, and MOM is the difference in return between last year's winner and loser portfolios. Standard deviations across all funds are in parentheses.

Country	RM	SMB	HML	MOM	R^2
Australia	0.95	0.05	0.11	0.02	0.86
Austria	1.07	0.03	0.05	-0.05	0.83
Belgium	0.97	0.10	0.00	-0.05	0.90
Canada	0.93	0.13	0.05	-0.03	0.89
Denmark	0.89	0.14	0.02	-0.04	0.86
Finland	1.03	0.59	0.47	0.00	0.83
France	1.00	0.36	0.05	-0.03	0.85
Germany	0.98	0.05	0.04	-0.05	0.92
India	0.90	0.31	-0.02	-0.03	0.86
Indonesia	0.76	-0.13	0.03	-0.01	0.78
Italy	1.07	0.10	0.03	0.02	0.96
Japan	1.00	0.15	-0.10	0.01	0.89
Malaysia	0.81	0.20	0.12	0.05	0.85
Netherlands	0.97	0.13	-0.01	-0.04	0.86
Norway	1.00	0.25	-0.01	-0.09	0.88
Poland	0.83	0.15	0.03	0.01	0.89
Portugal	0.95	0.02	0.00	-0.03	0.92
Singapore	0.96	0.08	-0.01	0.02	0.89
South Korea	0.89	0.18	0.06	0.08	0.86
Spain	0.96	-0.05	0.03	-0.01	0.92
Sweden	0.88	0.08	0.03	-0.04	0.92
Switzerland	1.08	0.24	0.14	-0.02	0.91
Taiwan	1.03	0.87	-0.41	0.06	0.74
Thailand	0.94	0.12	-0.03	0.05	0.94
UK	0.97	0.26	-0.04	-0.02	0.88
US	1.00	0.33	0.09	0.06	0.85
Total	0.98	0.26	0.05	0.03	0.87
	(0.46)	(0.43)	(0.38)	(1.06)	(0.12)
Total ex-US	0.96	0.19	0.01	0.00	0.88
	(0.19)	(0.33)	(0.25)	(0.14)	(0.10)

Table 3
Mutual Fund Characteristics

This table reports means of fund characteristics. The sample includes open-end actively managed domestic equity funds. The sample period is from 2000 to 2007. See Table A.3 in the Appendix for variable definitions. Standard deviations across all funds are in parentheses.

Country	Obs.	Return (% quarter)	Alpha Carhart Model (% quarter)	TNA ($ million)	Family TNA ($ million)	Age (years)	Expense Ratio (% year)	Total Load (%)	Flow (% quarter)	Number of Countries Sold	Manag. Team
Australia	2619	2.41	-1.29	123	22400	6.2	1.37	2.00	5.17	1.02	0.76
Austria	214	6.54	-0.31	58	8190	11.3	1.52	4.21	0.18	2.54	0.38
Belgium	546	4.92	0.75	89	8290	11.6	1.05	2.49	-1.38	2.32	0.92
Canada	5453	4.61	-0.58	265	19700	10.6	1.52	5.33	0.87	1.01	0.74
Denmark	410	5.82	1.36	138	5350	11.3	1.26	2.14	1.18	1.41	0.72
Finland	486	6.19	0.43	112	7990	8.5	1.58	1.97	2.78	1.40	0.58
France	7305	2.08	-1.36	158	9590	11.1	1.70	3.09	0.97	1.07	0.85
Germany	1733	3.46	-0.07	418	23000	17.5	1.24	4.45	-0.89	1.88	0.50
India	2101	12.24	0.57	38	13800	6.2	1.24	2.72	1.64	1.44	0.10
Indonesia	209	10.58	0.01	40	5710	7.6	1.78	2.86	13.40	1.05	0.05
Italy	1722	2.30	-0.20	282	17400	8.7	1.86	3.01	-1.20	1.00	0.92
Japan	10491	2.35	0.22	78	23200	7.9	1.38	2.32	-3.02	1.00	1.00
Malaysia	2633	4.72	0.34	40	2290	9.1	1.53	6.24	-2.02	1.06	0.61
Netherlands	474	3.93	-0.46	267	10100	11.3	1.08	2.03	-0.52	1.03	0.74
Norway	1181	6.94	-0.74	97	5710	9.8	1.61	2.85	-0.46	1.27	0.86
Poland	414	6.74	0.48	135	23200	5.4	3.25	4.25	12.77	1.00	0.78
Portugal	366	5.70	0.90	54	4400	7.1	1.93	2.53	-0.40	1.11	1.00
Singapore	270	5.57	0.11	45	6890	9.1	1.40	3.94	3.18	1.19	1.00
South Korea	6011	6.45	0.76	21	8520	4.5	2.68	0.05	-11.27	1.00	0.91
Spain	1979	5.31	-0.58	88	6300	9.3	1.97	0.77	0.00	1.01	0.81
Sweden	2358	4.62	-0.08	354	11500	11.0	1.33	0.79	1.41	1.08	0.77
Switzerland	1172	3.74	-0.29	271	12500	10.8	1.26	4.37	-1.22	1.63	0.51
Taiwan	984	5.38	-0.34	52	22700	8.8	1.55	2.72	6.42	1.00	0.00
Thailand	1989	7.32	0.92	11	968	8.3	1.37	1.20	-2.51	1.00	0.76
UK	6156	2.86	0.23	471	31000	16.0	1.46	4.21	0.27	1.75	0.23
US	58957	1.80	-0.30	949	44900	12.6	1.31	2.45	2.00	1.04	0.63
Total	118233	3.01	-0.20	558	30400	11.1	1.46	2.65	0.44	1.11	0.68
		(9.93)	(4.18)	(2780)	(90600)	(10.60)	(0.61)	(2.63)	(17.87)	(0.61)	(0.47)
Total ex-US	59276	4.21	-0.10	170	15900	9.6	1.62	2.85	-1.11	1.18	0.72
		(10.49)	(4.27)	(514)	(54600)	(8.01)	(0.68)	(2.52)	(17.89)	(0.83)	(0.45)

Table 4
Country Characteristics

This table reports means of country characteristics. The sample period is from 2000 to 2007. See Table A.3 in the Appendix for variable definitions. Standard deviations across all funds are in parentheses.

Country	GDP per capita ($)	Internet (%)	Share turnover (%)	Trading costs (bp)	Common law	Anti-director	Securit. regul.	Mutual fund industry age (years)	Mutual fund industry Herfindahl	Mutual fund equity/ market cap.
Australia	34,672	69.8	78.0	32.3	1	4	2	42	0.05	0.33
Austria	33,882	46.8	36.1	30.6	0	3	1	49	0.07	0.21
Belgium	31,868	41.0	49.7	30.0	0	3	1	57	0.17	0.29
Canada	34,848	54.2	63.5	32.4	1	4	3	74	0.04	0.17
Denmark	34,319	50.3	82.2	34.0	0	4	2	43	0.09	0.14
Finland	33,187	51.9	128.6	42.2	0	4	1	18	0.09	0.07
France	29,412	35.7	83.1	28.4	0	4	2	40	0.04	0.21
Germany	29,006	41.1	137.0	27.1	0	4	1	55	0.13	0.11
India	3,523	4.4	110.5	65.6	1	5	2	41	0.08	0.02
Indonesia	4,315	7.0	46.6	71.7	0	4	2	10	0.26	
Ireland	42,644	27.8	53.3	84.6	1	5	1	32	0.06	
Italy	28,410	41.3	121.8	32.2	0	2	1	21	0.05	0.13
Japan	30,222	56.3	100.6	20.8	0	5	1	39	0.10	0.08
Malaysia	11,006	40.3	30.2	55.7	1	5	2	46	0.16	
Netherlands	33,405	64.7	116.8	27.7	0	3	2	76	0.13	0.08
Norway	41,178	54.5	103.7	32.5	0	4	1	11	0.16	0.11
Poland	13,593	23.0	37.3		0	2		12	0.11	0.03
Portugal	21,183	26.5	53.1	33.2	0	3	2	19	0.19	0.04
Singapore	29,636	55.3	59.1	40.3	1	5	3	46	0.08	
South Korea	21,417	64.0	216.1	57.3	0	5	2	35	0.09	0.04
Spain	26,473	29.8	167.0	32.2	0	5	1	46	0.09	0.10
Sweden	31,772	69.7	115.4	30.9	0	4	1	46	0.15	0.21
Switzerland	35,685	46.6	92.9	29.7	0	3	1	66	0.14	0.05
Taiwan	31,889	.	132.6	47.9	0	3	2	23	0.07	
Thailand	8,445	10.1	85.2	59.6	1	4	2	10	0.11	
UK	32,730	44.9	129.8	50.8	1	5	2	70	0.02	0.13
US	39,605	58.0	150.6	24.8	1	3	3	80	0.05	0.28
Total	27,716	42.9	95.6	40.6	0	4	2	41	0.10	0.13

Table 5
Regression of Mutual Fund Performance

This table reports panel regressions of the performance of open-end actively managed domestic equity funds in 2000-2007. The dependent variable is the quarterly Carhart model alpha (percentage per quarter) estimated using monthly fund returns in U.S. dollars. Explanatory variables include fund characteristics, time dummies, and country dummies or country characteristics. See Table A.3 in the Appendix for variables definition. Robust t-statistics corrected for fund-level clustering are in parentheses.

	(1)	(2)	(3)	(4)	(5)	(6)
	U.S. Funds	Non-U.S. Funds				
TNA (log)	-0.0675	0.0517	0.0221	0.0332	0.0230	0.0344
	(-4.99)	(4.58)	(2.06)	(2.90)	(2.01)	(3.04)
Family TNA (log)	0.0303	0.0275	0.0384	0.0360	0.0400	0.0388
	(3.00)	(2.64)	(3.41)	(3.19)	(3.49)	(3.45)
Age (log)	-0.0020	-0.0825	-0.0531	-0.0677	-0.0550	-0.0742
	(-0.06)	(-2.64)	(-1.62)	(-2.08)	(-1.65)	(-2.29)
Expense ratio	-0.1347	-0.0489	-0.0698	-0.0879	-0.1420	-0.1004
	(-1.59)	(-1.41)	(-2.23)	(-2.81)	(-4.53)	(-3.37)
Total load	-0.0101	0.0120	0.0095	0.0284	0.0233	0.0177
	(-1.25)	(1.34)	(1.10)	(3.25)	(2.70)	(2.06)
Flow	0.0012	0.0111	0.0100	0.0103	0.0103	0.0101
	(1.06)	(9.76)	(8.54)	(8.78)	(8.69)	(8.47)
Alpha	0.0655	0.0105	0.0289	0.0295	0.0295	0.0279
	(9.07)	(1.58)	(4.10)	(4.21)	(4.19)	(3.95)
Management team	-0.1373	-0.1027	0.0149	-0.0755	-0.0689	0.0222
	(-3.40)	(-2.36)	(0.32)	(-1.62)	(-1.46)	(0.47)
Number of countries sold	0.1636	0.0080	0.0486	0.0573	0.0622	0.0403
	(1.80)	(0.39)	(1.95)	(2.27)	(2.44)	(1.66)
GDP per capita (log)			-0.2825	-0.4619	-0.4603	-0.1586
			(-3.52)	(-6.15)	(-5.92)	(-1.73)
Internet			0.0123	0.0154	0.0157	0.0152
			(6.19)	(7.71)	(7.65)	(7.42)
Share turnover			0.0055	0.0043	0.0056	
			(9.98)	(7.54)	(9.18)	
Trading costs						-0.0201
						(-7.90)
Common law			0.5790			
			(7.45)			
Anti-director rights				0.1558		0.2032
				(4.86)		(6.49)
Securities regulation					0.1293	
					(1.98)	
Mutual fund ind. age (log)			-0.0412	0.0466	0.1551	0.0297
			(-0.55)	(0.68)	(2.32)	(0.40)
Mutual fund ind. Herfindahl			5.2334	3.0447	3.1003	4.9513
			(6.33)	(4.26)	(3.40)	(6.39)
Mutual fund equity/market cap.			-4.1843	-3.6300	-3.9263	-3.8257
			(-11.71)	(-10.00)	(-10.73)	(-11.11)
Time dummies	Yes	Yes	Yes	Yes	Yes	Yes
Country dummies	No	Yes	No	No	No	No
Observations	58,957	59,276	53,191	53,191	52,777	52,777
R^2	0.103	0.048	0.050	0.049	0.049	0.049

Table 6
Distribution of Mutual Fund Size

This table reports the number of funds and the mean total net assets (TNA) under management in millions of U.S. dollars in each fund size quintile. Fund size quintile 1 (5) has the smallest (largest) funds in each quarter. Panel A reports the distribution of fund size for domestic funds and Panel B reports the distribution of fund size for international funds. The sample period is from 2000 to 2007. Standard deviations are in parentheses.

	Fund Size Quintile				
	1	2	3	4	5
Panel A: Domestic Funds					
US Funds					
Number of funds	392	393	393	393	393
TNA ($ millions)	13	57	152	436	4102
	(9)	(20)	(51)	(168)	(7920)
Non-US Funds					
Number of funds	395	395	395	395	396
TNA ($ millions)	2	11	32	96	726
	(2)	(6)	(15)	(47)	(1010)
Panel B: International Funds					
US Funds					
Number of funds	95	96	96	96	96
TNA ($ millions)	18	66	176	495	4304
	(14)	(35)	(101)	(302)	(7580)
Non-US Funds					
Number of funds	649	649	649	649	650
TNA ($ millions)	4	17	44	110	615
	(3)	(7)	(16)	(41)	(789)

Table 7
Regression of Mutual Fund Performance: Role of Fund Size and Liquidity

This table reports panel regressions of the performance of open-end actively managed equity funds in 2000-2007. The dependent variable is the quarterly Carhart model alpha (percentage per quarter) estimated using monthly fund returns in U.S. dollars. Explanatory variables include fund characteristics, time dummies, and country dummies. Regressions include the same fund characteristics (coefficients not shown) used in Table 5. Columns (1) and (2) use a sample of U.S. and non-U.S. domestic funds that exclude the funds in the bottom fund size quintile (Q1). Column (3) uses a sample of U.S. domestic funds that excludes the funds in the top fund size quintile. Column (4) uses a sample of U.S. domestic funds that excludes the funds in the top fund size quintile with the size breakpoint given by non-U.S. funds. Column (5) uses a sample of U.S. domestic funds that excludes the funds with size above the largest non-U.S. funds in each quarter. Columns (6) and (7) use a sample of U.S. and non-U.S. domestic funds and include an interaction term between the fund size (TNA) and a dummy variable that takes the value of one if a fund is below the median SMB factor loading in each quarter, and zero otherwise. Columns (8) and (9) use a sample of U.S. and non-U.S. international funds. See Table A.3 in the Appendix for variables definition. Robust t-statistics corrected for fund-level clustering are in parentheses.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Sample Excludes Q1		Sample Excludes Largest U.S. Funds			Large Cap Funds		International Funds	
	US Funds	Non-US Funds	Excludes Q5	Excludes Q5 Non-US	Excludes Max TNA Non-US	US Funds	Non-US Funds	US Funds	Non-US Funds
TNA (log)	-0.1071	0.0044	-0.1047	-0.0697	-0.0732	-0.0967	0.0384	0.0187	-0.0030
	(-6.12)	(0.30)	(-5.34)	(-3.39)	(-5.15)	(-3.69)	(1.63)	(0.72)	(-0.25)
Family TNA (log)	0.0309	0.0073	0.0274	0.0345	0.0294	0.0358	0.0370	0.0411	0.0226
	(2.72)	(0.68)	(2.53)	(2.90)	(2.87)	(1.81)	(2.19)	(1.53)	(2.03)
Large cap fund						-0.3174	0.0720		
						(-0.52)	(0.14)		
TNA (log) × Large cap fund						0.0500	0.0218		
						(2.02)	(0.83)		
Time dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country dummies	No	Yes	No	No	No	No	Yes	No	Yes
Observations	47188	47434	47153	32322	57288	58957	59276	14390	97421
R^2	0.113	0.046	0.096	0.099	0.099	0.103	0.049	0.07	0.03

Table 8
Robustness of Regression of Mutual Fund Performance

This table reports panel regressions of the performance of open-end actively managed domestic equity funds in 2000-2007. The dependent variable is the quarterly Carhart model alpha (percentage per quarter) estimated using monthly fund returns in U.S. dollars. Explanatory variables include fund characteristics, country dummies, and time dummies. Columns (1) and (6) use benchmark-adjusted returns. Columns (2) and (7) use market model alphas. Columns (3) and (8) use gross returns. Columns (4) and (9) use Fama-MacBeth cross-sectional regressions. Columns (5) and (10) include two lags of flows and performance as explanatory variables. Column (11) presents standard errors adjusted for country-level clustering. See Table A.3 in Appendix for variables definition. Robust t-statistics corrected for fund-level or country-level clustering (in column (11)) are in parentheses.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
	US Funds					Non-US Funds					
	Benchmark-adjusted	Market Model	Grosss Return	Fama-MacBeth	Lags	Benchmark-adjusted	Market Model	Gross Returns	Fama-MacBeth	Lags	Cluster by Country
TNA (log)	-0.0750	-0.1285	-0.0734	-0.0685	-0.0607	0.0171	0.0191	0.0517	0.0805	0.0767	0.0517
	(-5.11)	(-7.15)	(-5.99)	(-2.42)	(-4.77)	(1.57)	(1.63)	(4.58)	(2.46)	(6.14)	(2.46)
Family TNA (log)	0.0242	0.0351	0.0226	0.0281	0.0186	0.0156	0.0246	0.0273	0.0286	0.0224	0.0275
	(2.21)	(2.56)	(2.40)	(1.59)	(2.00)	(1.48)	(2.05)	(2.62)	(1.68)	(2.09)	(1.91)
Age (log)	0.0103	0.0735	0.0514	0.0050	0.0365	-0.0648	-0.0670	-0.0819	-0.1123	-0.1490	-0.0825
	(0.25)	(1.63)	(1.64)	(0.10)	(1.13)	(-2.19)	(-2.04)	(-2.62)	(-1.39)	(-4.41)	(-1.93)
Expense ratio	-0.3755	-0.3108	0.2484	-0.0978	-0.2034	-0.0891	-0.1183	0.2031	-0.0390	-0.0367	-0.0489
	(-4.27)	(-3.25)	(3.69)	(-0.72)	(-2.60)	(-2.32)	(-3.02)	(5.82)	(-0.52)	(-0.96)	(-0.77)
Total load	-0.0059	-0.0145	-0.0166	-0.0152	-0.0072	0.0059	0.0151	0.0117	0.0135	0.0109	0.0120
	(-0.65)	(-1.31)	(-2.25)	(-1.35)	(-0.98)	(0.63)	(1.54)	(1.30)	(1.12)	(1.11)	(0.96)
Flow_{t-1}	0.0020	-0.0023	0.0021	0.0012	-0.0016	-0.0001	-0.0002	0.0111	0.0063	0.0072	0.0111
	(1.66)	(-1.91)	(2.04)	(0.52)	(-1.29)	(-0.10)	(-0.17)	(9.76)	(1.79)	(5.62)	(2.17)
Flow_{t-2}					0.0030					-0.0021	
					(2.73)					(-1.77)	
Alpha_{t-1}	0.0603	0.1248	0.0650	0.0817	0.0599	0.0447	0.0004	0.0105	0.0853	0.0276	0.0105
	(7.87)	(21.19)	(7.64)	(2.39)	(8.12)	(6.73)	(0.07)	(1.58)	(2.43)	(3.71)	(0.46)
Alpha_{t-2}					0.0568					0.0068	
					(8.23)					(0.99)	
Number of countries sold	0.2436	0.2741	0.1848	0.1515	0.1086	0.0618	0.0609	0.0079	0.0776	0.0067	0.0080
	(2.73)	(2.04)	(2.06)	(1.93)	(1.41)	(3.40)	(3.30)	(0.38)	(1.02)	(0.32)	(0.29)
Management team	-0.0346	-0.0896	-0.1631	-0.1423	-0.1181	-0.1239	-0.1304	-0.1048	-0.1246	-0.1368	-0.1027
	(-0.75)	(-1.55)	(-4.16)	(-3.16)	(-3.21)	(-2.48)	(-2.51)	(-2.41)	(-1.52)	(-2.88)	(-1.20)
Time dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country dummies	No	No	No	No	No	Yes	Yes	Yes	Yes	Yes	Yes
Observations	57,747	58,957	58,957	58,957	53,783	58,337	59,276	59,276	59,276	47,937	59,276
R^2	0.092	0.137	0.103	0.055	0.066	0.039	0.076	0.051	0.307	0.053	0.048

Appendix

Table A.1
Top Three Domestic and International Equity Funds by Country

This table lists the top three open-end actively managed domestic and international equity funds by country. Funds are ranked by total net assets (sum of all share classes in U.S. dollars millions) as of December 2007.

Country	Domestic Funds		International Funds	
	Fund Name	TNA ($ million)	Fund Name	TNA ($ million)
Australia	Perpetual's W Industrial	4,525	Platinum Trust - Platinum International	8,035
	Vanguard idx Fd-Vanguard Australian Shares	3,325	AXA - Wholesale Global Equity - Value	4,358
	FirstChoice WI - CFS Wholesale Imputation	2,947	Vanguard idx Fd-Vanguard International Shares	4,291
Austria	Pioneer Funds Austria - Austria Stock	623	Raiffeisen-Eurasien-AktienFonds	1,997
	ESPA STOCK VIENNA EUR	249	Raiffeisen-Osteuropa-Aktien Fonds	1,923
	3 Banken Oesterreich-Fonds	199	Raiffeisen-Europa-Aktien	873
Belgium	Degroof Eq Belgium Active Benelux	517	Privileged Portfolio Equity Acc	2,242
	Fortis B Equity Belgium	504	Petercam Equities Europe Dividend Cap	1,694
	Dexia Equities B Belgium Cap	391	Degroof Equities EMU Behavioral Benelux	1,389
Canada	RBC Canadian Dividend	9,723	Mac Cundill Value Series	7,576
	CIBC Monthly Income	7,130	Fidelity Global Series	4,503
	CI Canadian Investment	6,594	Templeton Growth Ltd	4,452
Denmark	Danske Invest Danmark	699	Sparinvest Value Aktier	4,697
	Nordea Invest Danmark	556	Carnegie WorldWide / Globale Aktier	1,503
	BankInvest Danske Aktier	498	Jyske Invest Favorit Aktier	1,369
Finland	OP-Delta	1,119	Nordea Pro Stable Return Kasvu	835
	Danske Suomi Osake Tuotto	363	Nordea Maailma Kasvu	755
	Aktia Capital	336	OP-Eurooppa Osake	684
France	Atout France Cap	6,582	BNP Paribas Actions Euroland Dis	5,798
	Tricolore Rendement Cap	5,987	Atout Euroland	5,032
	Ecureuil Investissements	4,737	Magellan Cap/Dis	3,885
Germany	DekaFonds	7,066	DWS Vermoegensbildungsfonds	8,189
	DWS Investa	5,211	UniGlobal	6,495
	UniFonds	4,594	AriDeka	5,797
India	Reliance Growth Fund-Growth Plan	1,618		
	Reliance Diversified Power Sector Fund-Growth	1,511		
	HDFC Equity Fund-Growth	1,393		
Indonesia	Schroder Dana Prestasi Plus	1,009		
	Fortis Ekuitas	627		
	Manulife Dana Saham	319		
Ireland			First State China Growth	3,237
			Coutts Equator UK Equity Index Prgm	3,110
			First State Asian Equity Plus I	1,402
Italy	Sanpaolo Azioni Italia	1,365	Ducato Geo Europa	2,659
	Arca Azioni Italia	1,178	Anima Fondo Trading	1,704
	Allianz Azioni Italia	980	Sanpaolo Europe	1,464

Table A.1: continued

Country	Domestic Funds		International Funds	
	Fund Name	TNA ($ million)	Fund Name	TNA ($ million)
Japan	Fidelity Japan Growth Equity Fund	3511	Nomura Global High Income Stock Fund	2550
	Sawakami Fund	2231	Nikko CS Global High Yield Stock Fund M Div	1968
	Nomura Japan Equity Strategy	2211	HSBC India Open	1722
Malaysia	PRUlink Equity	755		
	Public Ittikal	459		
	Public Regular Savings	315		
Netherlands	Centraal Beheer Achmea Nederland fonds	1502	Fortis OBAM NV	7791
	ING Dutch	1134	AEGON Equity Fund	7225
	ABN AMRO Netherlands NV	1068	AEGON Equity Europe Fund	5254
Norway	Skagen Vekst	2132	Skagen Global	5257
	Pareto Aksje Norge	1064	Skagen Kon-Tiki	3661
	Odin Norge	1014	Odin Norden	1941
Poland	Arka BZ WBK Akcji FIO	2209		
	Pioneer Akcji Polskich FIO	1935		
	Legg Mason Akcji FIO	1020		
Portugal	Santander Accoes Portugal	368	Millennium Eurocarteira	465
	Millennium Accoes Portugal	237	BPI Reestructuracoes	371
	Caixagest Accoes Portugal	215	BPI Europa Valor	319
Singapore	Schroder Singapore Trust Class	380	PRU Dragon Peacock	1001
	DWS Singapore Equity	232	PruLink China-India	860
	ML Golden Singapore Growth	168	PruLink Asian Equity	811
South Korea	Korea Samsung Group Install Savings Equity	3513		
	Mirae Asset 300mil Target Good Comp Equity	2680		
	Mirae Asset Solomon Equity	2651		
Spain	Banif Acciones Espanolas, FI	589	Bestinfond, FI	1966
	BBVA Bolsa, FI	540	Santander Dividendo Europa, FI	1962
	Sabadell BS Espana Dividendo, FI	507	Bestinver Internacional, FI	1495
Sweden	Swedbank Robur Kapitalinvest	4927	East Capital Russian	2355
	Swedbank Robur Aktiefond Pension	3052	SEB Aktiesparfond	2,204
	Nordea Allemansfond Alfa	2740	East Capital Eastern European	1886
Switzerland	UBS (CH) Equity Fund - Switzerland	2578	UBS (CH) Equity Fund - European Opportunity	1093
	Credit Suisse Equity Swiss Blue Chips	1822	UBS (CH) Equity Fund - Emerging Asia	927
	UBS (CH) Inst Fd - Eq Switzerland	1554	Swisscanto (CH) Eq Fd Continental Europe	612
Taiwan	Capital Marathon Fund	595	JF (Taiwan) China Concept Fund	635
	Capital High Technology Fund	429	PCA India Fund	509
	Cathay Greater China Fund	416	JF (Taiwan) Asia Fund	445
Thailand	SCB Dividend Stock 70/30 Long Term Equity	280		
	K Equity LTF	156		
	Aberdeen Growth	134		
UK	Invesco Perpetual High Income Inc	18994	Fidelity European Acc	9519
	Invesco Perpetual Income Inc	13417	M&G Global Basics	5992
	Jupiter Income	7957	Standard Life Inv International Trust Acc	4414
US	American Growth Fund of America	193453	American EuroPacific Growth Fund	124010
	American Investment Company of America	89250	American Capital World Growth & Income Fund	113908
	American Washington Mutual Investors Fund	82424	American New Perspective Fund	61218

Table A.2
Summary Statistics of Performance Benchmarks

This table reports mean and standard deviation of monthly factor returns (percentage per month) in U.S. dollars of the Carhart model in 1997-2007. RM is the excess return on the domestic market, SMB is the difference in return between the small and big portfolios, HML is the difference in return between the high and low book-to-market portfolios, and MOM is the difference in return between last year's winner and loser portfolios.

Country	RM		SMB		HML		MOM	
	Mean	Std Dev	Mean	Std Dev	Mean	Std Dev	Mean	Std Dev
Australia	0.98	5.16	0.36	4.22	0.72	3.65	1.23	5.29
Austria	0.97	4.72	-0.44	3.47	1.49	4.07	1.43	4.42
Belgium	0.81	4.82	-0.26	2.64	0.70	2.75	0.50	5.09
Canada	1.06	5.42	0.53	4.05	0.49	4.84	2.16	5.95
Denmark	1.05	4.94	-0.27	3.68	0.64	4.54	0.51	4.81
Finland	1.63	8.95	-0.42	4.27	-0.31	7.18	0.98	6.56
France	0.94	5.18	-0.07	3.61	0.75	4.63	1.20	6.12
Germany	0.77	5.71	-0.39	3.89	0.76	4.59	1.45	7.11
India	1.85	8.55	0.57	5.16	0.80	7.84	1.48	7.17
Indonesia	0.76	14.52	-0.37	7.37	-2.13	8.98	-2.44	13.58
Ireland	0.78	5.25	-0.10	5.93	0.56	7.69	0.56	8.44
Italy	0.97	5.88	-0.15	3.52	0.70	3.40	0.75	4.91
Japan	0.03	5.69	-0.05	3.25	0.44	3.19	0.29	5.49
Malaysia	0.37	10.20	-0.58	5.03	1.05	5.53	-0.35	8.51
Netherlands	0.67	5.06	0.15	3.62	0.48	4.12	1.02	6.91
Norway	1.16	6.50	-0.19	3.99	0.24	4.81	1.43	6.47
Poland	1.18	9.30	-0.37	7.19	1.10	6.95	0.39	5.61
Portugal	0.93	5.56	-0.53	5.56	1.30	8.23	1.06	6.85
Singapore	0.59	7.30	-0.22	5.32	1.39	5.44	-0.44	7.58
South Korea	1.67	13.05	-0.32	4.89	1.06	5.75	-0.10	8.57
Spain	1.03	5.47	0.25	3.51	0.44	3.70	0.30	5.20
Sweden	0.92	6.97	-0.29	4.19	0.16	5.60	1.11	7.92
Switzerland	0.70	4.53	0.14	3.32	0.19	2.44	0.28	5.57
Taiwan	0.29	8.64	0.13	4.16	0.24	8.53	-0.04	2.71
Thailand	0.56	12.24	0.87	8.76	2.43	12.18	-0.54	6.38
UK	0.55	3.91	0.16	5.09	1.07	7.99	1.10	4.94
US	0.49	4.43	0.22	4.18	0.40	3.78	0.86	5.56
Total	0.63	4.15	0.11	2.63	0.54	2.72	0.81	4.30

Table A.3
Variables Definitions

Variable	Definition
	Panel A: Fund Characteristics
Alpha	Alpha (percentage per quarter) estimated with three-year of past monthly fund returns in U.S. dollars with several factor models (Lipper).
TNA	Total net assets in U.S. dollars millions of the fund primary share class (Lipper).
Family TNA	Total net assets in U.S. dollars millions of the fund family (parent management company) equity funds to which the fund belongs (Lipper).
Fund age	Number of years since the fund launch date (Lipper).
Expense ratio	Total annual expenses as a fraction of total net assets (Lipper).
Total load	Sum of front-end and back-end loads (Lipper).
Flow	Percentage growth in TNA (in local currency) in a quarter, net of internal growth (assuming reinvestment of dividends and distributions).
Number of countries sold	Number of countries where the fund is sold (Lipper).
Management team	Dummy variable that equals one when the fund is managed by more than one person or by a team, and zero otherwise (Lipper).
Large cap fund	Dummy that equals one if a fund TNA is below the median SMB factor loading, and zero otherwise (Lipper).
	Panel B: Country Characteristics
GDP per capita	Gross domestic product per capita in U.S. dollars (WDI).
Internet	Ratio of number of internet users to population (WDI).
Share turnover	Ratio of total value of stocks traded to stock market capitalization (WDI).
Trading costs	Trading costs in basis points (Global Universe Data-ElkinsMcSherry).
Common law	Dummy variable that equals one when a country's legal origin is common law, and zero otherwise (La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1997)).
Anti-director rights	Index of minority shareholder protection (Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2008)).
Securities regulation	Sum of the disclosure requirements, liability standards, and public enforcement indices (La Porta, Lopez-de-Silanes, and Shleifer (2006)).
Mutual fund industry age	Mutual fund industry age in years (Khorana, Servaes, and Tufano (2005)).
Mutual fund industry Herfindahl	Sum of squared market shares of parent management companies for equity funds in each country (Lipper).
Mutual fund equity/market cap.	Assets under management of equity mutual funds divided by market capitalization (EFAMA and WDI).