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The Performance of Bond Mutual Funds*

Using linear and nonlinear models, we examine two samples of bond funds: one sample designed to eliminate survivorship bias, and a second much larger sample. Overall and for subcategories of bond funds, we find that bond funds underperform relevant indexes post-expenses. Our results are robust across a wide choice of models. We find that, on average, a percentage-point increase in expenses leads to a percentage-point decrease in performance. The nonlinear model weights closely match actual composition weights. We find no evidence of predictability using past performance to predict future performance for our unbiased sample.

I. Introduction

The subject of mutual fund performance has received a great deal of attention in the literature of financial economics. Alternative metrics for performance have been proposed, and mutual fund performance has been examined extensively.[1] However, almost all of the empirical work on mutual fund performance has involved either common stock funds or funds that invest in both common stock and debt instruments (e.g., balanced funds). In this study, we will examine the performance of mutual funds that restrict their investments almost exclusively to debt instruments: bond funds.

There are several reasons why this study is important. First, bond funds constitute a major

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1. See, e.g., Treynor (1965), Sharpe (1966), Jensen (1968), Grinblatt and Titman (1989*a*), Cumby and Glenn (1990), and Elton, Gruber, Das, and Hlavka (1992).

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