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Evaluating the Performance of International Mutual Funds

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ABSTRACT

In this paper, we examine the performance of a sample of fifteen U.S.-based internationally diversified mutual funds between 1982 and 1988. Two performance measures are used, the Jensen measure and the positive period weighting measure proposed by Grinblatt and Titman. We find no evidence that the funds, either individually or as a whole, provide investors with performance that surpasses that of a broad, international equity index over this sample period.

IT IS WIDELY RECOGNIZED that international diversification may produce significant reductions in systematic risk. One way for investors to achieve such diversification without investing in costly information acquisition is through internationally diversified mutual funds. In addition to providing diversification, do fund managers possess information that provides superior returns for an uninformed investor? While considerable evidence on the behavior of mutual fund returns now exists, there is surprisingly little evidence about the performance of internationally diversified funds.[1] This paper attempts to remedy that deficiency by providing empirical evidence on the performance of a sample of U.S.-based internationally diversified mutual funds.

Two measures of performance are utilized in this paper. The first is the widely used Jensen (1968, 1969) measure, which uses the security market line to evaluate fund performance. The second is Grinblatt and Titman's (1989b) positive period weighting measure. While popular, the Jensen measure is subject to well known limitations, the most important of which is the possibility that errors in inference may arise when the fund manager is a market timer. In particular, the Jensen measure may indicate poor performance when the manager possesses and utilizes superior timing information. The performance measure suggested by Grinblatt and Titman (1989b) is not subject to these problems but has other limitations.

The plan of the paper is as follows. Section I briefly discusses Grinblatt and Titman's performance measure and compares it with Jensen's measure. In order to obtain valid inference with either measure, the benchmark used to evaluate fund performance must be mean-variance efficient from the point of view of the

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[1] Particular attention should be paid to internationally diversified funds since the benchmark portfolios used in existing studies of mutual fund performance are purely domestic and may therefore be inappropriate for evaluating the performance of internationally diversified funds.