A report on the performance of 57 funds and their sensitivity to market fluctuations.

Can Mutual Funds Outguess the Market?

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Are mutual fund managers successfully anticipating major turns in the stock market? There is a widely held belief that they are. Whether investment managers themselves actually share this belief is hard to say. At one time or another in promoting their services, however, a number of mutual funds have used the claim that they can anticipate major stock market movements.

We have devised a statistical test of mutual funds' historical success in anticipating major turns in the stock market. Applying this test to the performance record of 57 open-end mutual funds (as reported in this article), we find no evidence to support the belief that mutual fund managers can outguess the market.

Debated Responsibilities

The question we have studied has an important bearing on the responsibilities which investment managers can properly be asked to assume. For instance, today almost everyone agrees that the market was dangerously high in early 1929 and that stocks were a bargain in the 1950's. On hindsight, laymen are tempted to think that these extremes should have been "obvious" to fund managers at the time, and that they should have sold or bought common stocks accordingly. In actuality, of course, fund managers did *not* always sell in 1929 and buy in the 1950's.

What position should the fund manager take to protect himself against accusations that he should have anticipated market movements in this way? More broadly, what does the shareholder have a right to expect from the fund manager? Is the fund manager speculating if he attempts to anticipate major market movements? Or is he negligent if he fails to try? It seems to us that the answers to these questions depend in part on whether or not investment managers actually have the *ability* to anticipate major turns in the stock market.

Because a mutual fund's performance in each succeeding year is readily measured, widely published, and easily compared with that of other mutual funds, managers in this industry are perhaps particularly sensitive to the effect on their funds' performance of a market decline or market rise during the year. We believe that our findings may have significance not only for mutual fund managers, but also for pension, trust, and endowment fund managers — despite the fact that their objectives vary widely. If it is generally true that investment managers cannot outguess the market, then it may be necessary to revise certain conceptions about the responsibilities of investment management across the board.

Analytical Approach

It is well known that there is a definite tendency for the prices of most common stocks to move up and down together. Because this tendency exists, it is meaningful to talk about fluctuations in the "market." It is also well known