

## On the Timing Ability of Mutual Fund Managers

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### ABSTRACT

Existing studies of mutual fund market timing analyze monthly returns and find little evidence of timing ability. We show that daily tests are more powerful and that mutual funds exhibit significant timing ability more often in daily tests than in monthly tests. We construct a set of synthetic fund returns in order to control for spurious results. The daily timing coefficients of the majority of funds are significantly different from their synthetic counterparts. These results suggest that mutual funds may possess more timing ability than previously documented.

THE PERFORMANCE OF MUTUAL FUNDS RECEIVES a great deal of attention from both practitioners and academics. Almost 50 percent of U.S. households invest in mutual funds, with an aggregate investment of over five trillion dollars (Investment Company Institute, 2000). Given the size of their stake, the investing public's interest in identifying successful fund managers is understandable, especially in light of mounting evidence that the returns of most actively managed funds are lower than index fund returns.<sup>1</sup> From an academic perspective, the goal of identifying superior fund managers is interesting because it challenges the efficient market hypothesis.

In this paper, we examine the ability of mutual fund managers to time the market, that is, to increase a fund's exposure to the market index prior to market advances and to decrease exposure prior to market declines. Most existing studies find little evidence that fund managers possess market timing ability. Treynor and Mazuy ((1966), hereafter referred to as TM), for example, develop a test of market timing and find significant ability in only 1 fund out of 57 in their sample. Henriksson (1984) uses the market timing test of Henriksson and Merton ((1981), hereafter referred to as HM) and finds that only 3 funds out of 116 exhibit significant positive market timing ability. Graham and Harvey (1996) analyze investment newsletters' suggested allocations between equity and cash, thereby measuring explicitly the

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<sup>1</sup> According to the *Wall Street Journal* (1999), 91 percent of actively managed stock funds generated lower returns than the S&P 500 index over the 10 years ending in December 1998, and 84 percent trailed the Wilshire 5000 over the same period.