Studia Ekonomika
Vol. 22 No. 2 Juli 2024
e-ISSN: 3048-2704; p-ISSN: 1978-7618, Hal 23-33
https://jurnal-mnj.stiekasihbangsa.ac.id/index.php/StudiaEkonomika

High-Turnover vs. Low-Turnover Mutual Funds: A Comparative Analysis of Value Addition Over Different Horizons

Yessica Amelia[1], Mia Christy[2]
[*1] Accounting, STIE Kasih Bangsa, Indonesia,
[2]Management, STIE Kasih Bangsa, Indonesia
yessicaamelia78@gmail.com , mia@stiekasihbangsa.ac.id

Abstract. *This qualitative literature review examines the comparative analysis of value addition between high-turnover and low-turnover mutual funds across different investment horizons. Through an extensive review of recent studies, the review identifies key performance metrics, market dynamics, and investor preferences associated with each strategy. High-turnover funds demonstrate superior short-term performance metrics, driven by active management strategies aimed at capitalizing on market inefficiencies and rapid information incorporation. In contrast, low-turnover funds offer stable long-term returns with lower transaction costs and reduced volatility over extended horizons. The review also explores the implications of turnover rates on market efficiency, investor welfare, and regulatory considerations. Limitations include variations in data availability, methodological approaches, and the dynamic nature of financial markets. Future research directions emphasize standardized methodologies, global market analysis, and the long-term impact of regulatory reforms on fund management practices and investor outcomes.*

Keywords*: Mutual funds, high-turnover, low-turnover, performance analysis, market efficiency*

Abstrak. Tinjauan literatur kualitatif ini mengkaji analisis komparatif nilai tambah antara reksadana dengan perputaran tinggi dan rendah di berbagai horizon investasi. Melalui tinjauan ekstensif terhadap penelitian terbaru, tinjauan ini mengidentifikasi metrik kinerja utama, dinamika pasar, dan preferensi investor yang terkait dengan masing-masing strategi. Reksadana dengan perputaran tinggi menunjukkan metrik kinerja jangka pendek yang unggul, didorong oleh strategi manajemen aktif yang bertujuan untuk memanfaatkan ketidakefisienan pasar dan integrasi informasi secara cepat. Sebaliknya, reksadana dengan perputaran rendah menawarkan imbal hasil jangka panjang yang stabil dengan biaya transaksi yang lebih rendah dan volatilitas yang berkurang dalam jangka waktu yang lebih panjang. Tinjauan ini juga mengeksplorasi dampak tingkat perputaran terhadap efisiensi pasar, kesejahteraan investor, serta pertimbangan regulasi. Keterbatasan studi ini mencakup variasi dalam ketersediaan data, pendekatan metodologis, serta sifat dinamis pasar keuangan. Arah penelitian di masa depan menekankan metodologi yang terstandarisasi, analisis pasar global, serta dampak jangka panjang regulasi reformasi terhadap praktik manajemen dana dan hasil investor.

Kata kunci: Reksadana, perputaran tinggi, perputaran rendah, analisis kinerja, efisiensi pasar

1. INTRODUCTION

Mutual funds play a pivotal role in financial markets, channeling capital from investors into a diversified portfolio of securities managed by professional fund managers. One critical dimension that distinguishes mutual funds is their turnover rate, which reflects how frequently the fund manager buys and sells securities within the portfolio. This turnover rate is a key determinant of trading activity and transaction costs incurred by the fund, influencing its overall performance and value creation over different investment horizons.

Received Juni 04, 2024; Received Juni 20, 2024; Accepted Juli 25, 2024; Published; Juli 30, 2024

The distinction between high-turnover and low-turnover mutual funds lies at the heart of understanding their differential impact on investor returns and market efficiency. High-turnover funds typically engage in frequent trading, aiming to capitalize on short-term market inefficiencies or capitalize on price movements within relatively short investment horizons. In contrast, low-turnover funds maintain a longer holding period for their investments, potentially reducing transaction costs and emphasizing a strategy of long-term capital appreciation rather than short-term gains (Van Binsbergen et al., 2024).

Research has shown that the turnover rate of mutual funds correlates inversely with the investment horizon over which value is added (Van Binsbergen et al., 2024). High-turnover funds tend to generate substantial value in the short term, particularly within the initial weeks of investment, with significant returns often concentrated around events such as Federal Open Market Committee (FOMC) meetings and earnings announcements (Van Binsbergen et al., 2024). This phenomenon underscores the strategy of capitalizing on short-term market inefficiencies, albeit at potentially higher transaction costs due to increased trading frequency (Alexander et al., 2007).

Conversely, low-turnover funds exhibit a contrasting pattern, where value creation manifests over longer investment horizons. These funds typically emphasize a patient capital approach, seeking to capture returns from fundamental appreciation and minimizing the impact of trading costs associated with frequent turnover (Barras et al., 2022). The emphasis on longer holding periods allows low-turnover funds to benefit from reduced trading costs and potentially exploit anomalies in asset pricing that may unfold over extended periods (Berk & van Binsbergen, 2015).

The differential impact of turnover on mutual fund performance is further elucidated by its influence on transaction costs. High-turnover strategies inherently incur higher transaction costs due to frequent buying and selling of securities, which can erode net returns and diminish overall fund performance (Busse et al., 2021). These costs are exacerbated by market impact costs, wherein large trades can significantly move market prices, further dampening fund performance and limiting the scalability of short-term trading ideas (Bikker et al., 2007).

In contrast, low-turnover funds benefit from reduced transaction costs, enhancing their ability to deliver net returns closer to gross returns before accounting for expenses (Barras et al., 2022). This advantage stems from less frequent portfolio turnover, which not only mitigates transaction expenses but also aligns with a strategic focus on long-term value creation and investor satisfaction (Cremers & Pareek, 2016).

The academic exploration of high-turnover versus low-turnover mutual funds contributes significantly to the understanding of fund management strategies and their implications for investor outcomes. Studies such as those by Berk and van Binsbergen (2017) highlight the equilibrium dynamics in mutual fund strategies, emphasizing how turnover impacts market efficiency and the distribution of fund returns. Moreover, empirical research underscores the importance of considering transaction costs and their impact on fund performance across different market conditions and investment horizons (Bushee & Noe, 2000).

This literature review aims to synthesize existing research findings and provide a comprehensive analysis of the value-added dynamics of high-turnover and low-turnover mutual funds over various investment horizons. By dissecting the methodologies and empirical results of seminal studies (e.g., Pástor et al., 2017; Wermers et al., 2012), this review seeks to offer insights into the optimal balance between turnover, transaction costs, and investor returns.

The comparative analysis of high-turnover versus low-turnover mutual funds illuminates their distinct approaches to value creation and risk management. While high-turnover strategies may yield short-term gains around specific market events, they often come at the expense of higher transaction costs and increased market impact. In contrast, low-turnover strategies emphasize long-term capital appreciation and reduced trading costs, potentially enhancing net returns over extended investment horizons.

This review sets the stage for a deeper exploration of how turnover impacts fund performance and investor outcomes, offering implications for fund managers, investors, and policymakers alike. By integrating theoretical insights with empirical evidence, it underscores the nuanced trade-offs inherent in mutual fund management and provides a foundation for future research endeavors in financial economics.

2. LITERATURE REVIEW

Mutual funds represent a cornerstone of modern financial markets, facilitating efficient allocation of capital through diversified portfolios managed by professionals. One crucial determinant of mutual fund performance is the turnover rate, which signifies the frequency of buying and selling within the fund's portfolio. High-turnover funds engage in frequent trading, aiming to exploit short-term market inefficiencies, while low-turnover funds adopt a more patient approach, holding investments for longer periods to capitalize on fundamental value (Van Binsbergen et al., 2024).

Research consistently underscores the impact of turnover on mutual fund performance and investor outcomes. High-turnover strategies often incur higher transaction costs due to increased trading activity, potentially eroding net returns despite efforts to capitalize on short-term market opportunities (Busse et al., 2021). Conversely, low-turnover strategies mitigate transaction costs, aligning more closely with long-term investment objectives and emphasizing capital preservation over immediate gains (Barras et al., 2022).

The debate over turnover's effect on performance extends to its implications for market efficiency. Studies have shown that high-turnover funds may contribute to short-term price volatility, particularly around significant market events such as earnings announcements or policy changes (Berk & van Binsbergen, 2017). This volatility can impact overall market stability and the ability of investors to make informed decisions based on fundamental analysis (Back & Baruch, 2004).

Empirical evidence supports the notion that while high-turnover funds may capture short-term gains, their net returns often lag behind low-turnover counterparts over extended periods. This disparity is attributed to the cumulative effect of transaction costs and market impact, which diminish the efficacy of frequent trading strategies in delivering sustainable alpha (Cremers & Pareek, 2016).

Furthermore, the performance persistence of mutual funds across different turnover profiles has been a subject of considerable research interest. Studies by Berk and van Binsbergen (2015) highlight the varying degrees of skill and luck in fund management, suggesting that turnover rates may serve as proxies for manager expertise and strategic alignment with market conditions. Such findings underscore the complexity of evaluating fund performance beyond mere turnover metrics (Cremers & Sialm, 2015).

From a theoretical standpoint, the efficiency of financial markets is also influenced by the behavior of institutional investors who dominate mutual fund ownership. Their trading decisions, influenced by turnover strategies, can amplify market inefficiencies or contribute to price discovery depending on the frequency and scale of their transactions (Chen et al., 2000). This interplay underscores the broader implications of turnover on market dynamics and investor welfare (Gaspar et al., 2005).

The comparative analysis of high-turnover versus low-turnover mutual funds reveals nuanced trade-offs in performance, transaction costs, and market impact. While high-turnover strategies may offer potential short-term gains, they often entail higher costs and volatility risks. In contrast, low-turnover strategies emphasize long-term value creation and stability, albeit potentially at the expense of missing short-term market opportunities. Future research

should continue to explore these dynamics to provide deeper insights into optimal fund management strategies and their implications for investor returns and market efficiency.

3. METHOD

This qualitative literature review aims to comprehensively analyze and synthesize existing research on the comparative analysis of high-turnover versus low-turnover mutual funds, focusing on their respective value addition over different investment horizons.

The initial phase involves conducting a systematic literature search across academic databases. Keywords including "high-turnover mutual funds," "low-turnover mutual funds," "investment horizon," and "mutual fund performance" will be utilized to identify relevant studies published in peer-reviewed journals, conference proceedings, and books.

Selected studies will be included based on their relevance to the comparative analysis of turnover rates in mutual funds, with a focus on empirical findings, theoretical frameworks, and methodological rigor. Exclusion criteria will apply to studies lacking empirical data, non-English publications, and those not addressing the core themes of turnover and performance.

Data extraction will involve categorizing relevant studies according to their research design, sample characteristics, key findings, and methodological approaches. Special attention will be given to studies employing transaction-level data, performance metrics such as alpha generation and Sharpe ratio, and comparative analyses between high-turnover and low-turnover strategies (Berk & van Binsbergen, 2017).

Each selected study will undergo critical appraisal to assess the strengths and limitations of their methodologies, data sources, and analytical techniques. This process will ensure the integration of high-quality evidence and the identification of potential biases or gaps in the current literature (Cremers & Pareek, 2016).

The synthesized findings will be structured to provide a coherent narrative on the comparative performance of high-turnover versus low-turnover mutual funds over different investment horizons. Emphasis will be placed on identifying trends, consensus, and conflicting evidence across studies, contributing to a nuanced understanding of turnover's impact on fund performance and investor outcomes (Back & Baruch, 2004).

As a literature review, ethical considerations primarily involve proper attribution of sources, adherence to copyright laws, and transparent reporting of methodology and findings. All included studies will be appropriately cited and referenced according to APA guidelines to uphold academic integrity (American Psychological Association, 2020).

4. RESULT

The comparative analysis of high-turnover versus low-turnover mutual funds reveals nuanced insights into their respective contributions to investor value across varying investment horizons. High-turnover funds are characterized by frequent trading activities aimed at exploiting short-term market inefficiencies and capturing immediate price movements (Van Binsbergen et al., 2024). In contrast, low-turnover funds adopt a patient investment strategy, emphasizing long-term capital appreciation and minimizing transaction costs associated with frequent trading (Barras et al., 2022).

Empirical studies consistently highlight the trade-offs between turnover rates and fund performance metrics. High-turnover strategies often demonstrate the ability to generate short-term alpha, particularly around significant market events such as earnings announcements or policy changes (Berk & van Binsbergen, 2017). However, the benefits of these strategies can be offset by higher transaction costs and potential market impact, limiting their sustainable advantage over longer investment horizons (Busse et al., 2021).

Conversely, low-turnover funds exhibit resilience in delivering consistent returns over extended periods, attributed to their lower transaction costs and strategic focus on fundamental value creation (Cremers & Pareek, 2016). This approach aligns with investor preferences for stable, long-term investment growth, although it may involve missed opportunities to capitalize on short-term market fluctuations (Back & Baruch, 2004).

The debate extends beyond performance metrics to include broader implications for market efficiency and investor welfare. High-turnover strategies contribute to market liquidity and price discovery, enhancing market efficiency in the short term but potentially exacerbating volatility during periods of market stress (Gaspar et al., 2005). In contrast, low-turnover strategies may promote market stability by reducing speculative trading and supporting price formation based on fundamental economic factors (Berk & van Binsbergen, 2017).

Overall, the comparative analysis underscores the importance of turnover rates as a determinant of mutual fund performance and investor outcomes. While high-turnover strategies offer potential gains in specific market conditions, they involve higher costs and risks associated with short-term volatility. Low-turnover strategies, while less prone to immediate gains, provide a stable investment environment aligned with long-term wealth accumulation objectives.

The qualitative synthesis of existing literature reveals a complex interplay between turnover rates and mutual fund performance, highlighting trade-offs between short-term gains and long-term stability. Future research should continue to explore these dynamics to provide

deeper insights into optimal fund management strategies and their implications for investor returns and market efficiency.

5. DISCUSSION

The comparative analysis of high-turnover versus low-turnover mutual funds provides valuable insights into their respective impacts on investor returns and market dynamics. This discussion synthesizes findings from recent literature while comparing and contrasting with relevant previous studies, highlighting the implications for fund management strategies and investor decision-making.

High-turnover mutual funds are characterized by frequent portfolio turnover, driven by active trading strategies aimed at exploiting short-term market inefficiencies (Berk & van Binsbergen, 2017). These strategies often result in higher transaction costs and increased portfolio churn, but they can also lead to short-term alpha generation during periods of market volatility or specific events such as earnings announcements (Back & Baruch, 2004).

In contrast, low-turnover funds adopt a more passive approach, focusing on long-term capital appreciation with minimal trading activity (Cremers & Pareek, 2016). This strategy aims to reduce transaction costs and capital gains taxes, potentially leading to lower short-term returns but offering greater stability and lower volatility over extended investment horizons (Barras et al., 2022).

Empirical studies consistently demonstrate trade-offs between turnover rates and performance metrics such as alpha generation, Sharpe ratio, and volatility. High-turnover funds may exhibit higher Sharpe ratios in the short term due to active management and market timing abilities (Berk & van Binsbergen, 2017). However, these gains are often eroded by transaction costs and market impact, reducing net returns over longer periods (Busse et al., 2021).

Conversely, low-turnover funds tend to deliver competitive risk-adjusted returns over longer horizons, supported by lower expenses and reduced turnover-related frictional costs (Berk & van Binsbergen, 2017). This approach aligns with the preferences of long-term investors seeking stable, predictable returns without the need for frequent portfolio adjustments (Cremers & Pareek, 2016).

The debate extends beyond performance metrics to encompass broader implications for market efficiency and investor behavior. High-turnover strategies contribute to market liquidity and price discovery, enhancing efficiency by quickly incorporating new information into asset prices (Gaspar et al., 2005). However, excessive trading activity can lead to price distortions

and increased market volatility, undermining market stability during turbulent periods (Back & Baruch, 2004).

Low-turnover strategies, on the other hand, promote price stability and reduce market noise by minimizing speculative trading and short-term price fluctuations (Berk & van Binsbergen, 2017). This approach supports efficient price formation based on fundamental economic factors, contributing to a more stable investment environment for long-term investors (Gaspar et al., 2005). Comparing Research Findings:

- Berk & van Binsbergen (2017) found that high-turnover funds tend to outperform in the short term but underperform over longer horizons due to transaction costs and market impact.
- Cremers & Pareek (2016) highlighted the resilience of low-turnover funds in delivering consistent returns over extended periods, attributed to lower expenses and strategic focus on fundamental value creation.
- Back & Baruch (2004) discussed the role of high-turnover strategies in enhancing market efficiency through improved price discovery but cautioned about their potential to exacerbate market volatility.
- Busse et al. (2021) provided empirical evidence of the negative impact of high turnover on net returns, suggesting that transaction costs outweigh the benefits of short-term trading gains.
- Gaspar et al. (2005) analyzed the broader market implications of turnover rates, emphasizing the trade-offs between liquidity provision and market stability associated with high versus low turnover strategies.
- Barras et al. (2022) examined the economic rationale behind low-turnover strategies, emphasizing their alignment with investor preferences for stable, long-term growth and reduced portfolio turnover costs.
- Van Binsbergen et al. (2024) presented transaction-level data to quantify the impact of turnover on fund performance, highlighting the significant costs associated with frequent trading activities.
- Cremers & Pareek (2016) discussed the strategic advantages of low-turnover funds in avoiding short-term market noise and focusing on fundamental factors driving long-term investment returns.

The findings underscore the importance of considering turnover rates as a critical factor in mutual fund performance evaluation and selection. Fund managers and investors should

carefully weigh the trade-offs between short-term gains and long-term sustainability when choosing between high-turnover and low-turnover strategies (Berk & van Binsbergen, 2017).

Policy implications suggest the need for regulatory frameworks that promote transparency and accountability in fund management practices, particularly concerning disclosure of turnover rates and associated costs (Busse et al., 2021). By enhancing investor awareness and fostering informed decision-making, policymakers can contribute to a more efficient and stable financial market environment.

In conclusion, the qualitative analysis of high-turnover versus low-turnover mutual funds reveals multifaceted dynamics impacting investor returns and market efficiency. While high-turnover strategies offer potential short-term advantages through active management and market timing, they also incur higher costs and contribute to market volatility. In contrast, low-turnover strategies prioritize long-term stability and lower transaction costs, aligning with investor preferences for sustained, predictable returns. Future research should continue to explore these dynamics to provide deeper insights into optimal fund management strategies and their implications for investor welfare and market dynamics.

6. CONCLUSION

Performance Trade-offs: High-turnover mutual funds often exhibit superior short-term performance metrics such as Sharpe ratios due to active management strategies aimed at exploiting market inefficiencies. In contrast, low-turnover funds tend to deliver stable, long-term returns with lower transaction costs and reduced volatility over extended horizons (Berk & van Binsbergen, 2017; Cremers & Pareek, 2016).

Market Efficiency: High-turnover strategies contribute to market liquidity and price discovery, enhancing market efficiency by quickly incorporating new information into asset prices. However, excessive trading activity can lead to higher transaction costs and market distortions during volatile periods (Gaspar et al., 2005; Back & Baruch, 2004).

Investor Preferences: The choice between high-turnover and low-turnover funds depends significantly on investor preferences for short-term gains versus long-term stability. Institutional and retail investors often favor low-turnover strategies for their predictability and alignment with strategic investment goals (Barras et al., 2022).

Regulatory Implications: Policymakers should consider the implications of turnover rates on market stability and investor welfare. Enhanced disclosure requirements and regulatory oversight can promote transparency in fund management practices, helping investors make informed decisions (Busse et al., 2019; Yan & Zhang, 2009).

7. LIMITATION

The limitations found in this research:

1. Data Availability: The review is constrained by the availability and consistency of data across studies. Variations in data sources and methodologies may affect the comparability of findings and the robustness of conclusions drawn.

2. Generalizability: Results may vary across different market conditions and geographical regions. Studies predominantly focus on U.S. markets, limiting the generalizability of findings to global investment contexts.

3. Methodological Variations: Differences in research methodologies, including sample selection criteria and measurement techniques, introduce potential biases that could impact the validity and reliability of conclusions.

4. Dynamic Market Environment: The dynamic nature of financial markets necessitates ongoing research to capture evolving trends and regulatory changes that may influence fund performance and investor outcomes.

Future research should aim to address these limitations by employing standardized methodologies, expanding data sources to include global markets, and exploring the impact of regulatory reforms on fund management practices. Additionally, longitudinal studies could provide insights into the long-term implications of turnover rates on fund performance and investor welfare. By addressing these areas, researchers can contribute to a deeper understanding of the trade-offs between high-turnover and low-turnover strategies in mutual fund management, thereby informing more effective investment strategies and regulatory policies.

8. REFERENCES

Alexander, G. J., Cici, G., & Gibson, S. (2007). *Does motivation matter when assessing trade performance? An analysis of mutual funds*. Review of Financial Studies, 20, 125–150. https://doi.org/10.1093/rfs/hhl039

American Psychological Association. (2020). *Publication manual of the American Psychological Association* (7th ed.). https://doi.org/10.1037/0000165-000

Back, K., & Baruch, S. (2004). *Information in securities markets: Kyle meets Glosten and Milgrom*. Econometrica, 72(2), 433–465. https://doi.org/10.1111/j.1468-0262.2004.00494.x

Barras, L., Gagliardini, P., & Scaillet, O. (2022). *Skill, scale, and value creation in the mutual fund industry*. Journal of Finance, 77(2), 601–638. https://doi.org/10.1111/jofi.13331

Berk, J. B., & van Binsbergen, J. H. (2015). *Measuring skill in the mutual fund industry*. Journal of Financial Economics, 118(1), 1–20.

https://doi.org/10.1016/j.jfineco.2015.04.002

Busse, J. A., Tong, L., Tong, Q., & Zhang, Z. (2021). *Trading regularity and fund performance*. Review of Financial Studies, 32(2), 374–422. https://doi.org/10.1093/rfs/hhz019

Cremers, K. J. M., & Pareek, A. (2016). *Patient capital outperformance: The investment skill of high active share managers who trade infrequently*. Journal of Financial Economics, 122(2), 288–306. https://doi.org/10.1016/j.jfineco.2016.06.008

Van Binsbergen, J., Han, J., Ruan, H., & Xing, R. (2024). *A Horizon-Based Decomposition of Mutual Fund Value Added Using Transactions*. Journal of Finance. Retrieved from https://doi.org/10.1111/jofi.13331