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The Quarterly Journal of Economics, Volume 119, Issue 2, May 2004, Pages 403–456, https://doi.org/10.1162/0033553041382184

Published: 01 May 2004

Abstract

We investigate the role that nonportfolio fund differentiation and information/search frictions play in creating two salient features of the mutual fund industry: the large number of funds and the sizable dispersion in fund fees. In a case study, we find that despite the financial homogeneity of S&P 500 index funds, this sector exhibits the fund proliferation and fee dispersion observed in the broader industry. We show how extra-portfolio mechanisms explain these features. These mechanisms also suggest an explanation for the puzzling late-1990s shift in sector assets to more expensive (and often newly entered) funds: an influx of high-information-cost novice investors.

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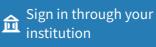
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