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Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry

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Abstract

Many investors purchase mutual funds through intermediated channels, paying brokers or financial advisors for fund selection and advice. This article attempts to quantify the benefits that investors enjoy in exchange for the costs of these services. We study broker-sold and direct-sold funds from 1996 to 2004, and fail to find that brokers deliver substantial tangible benefits. Relative to direct-sold funds, broker-sold funds deliver lower risk-adjusted returns, even before subtracting distribution costs. These results hold across fund objectives, with the exception of foreign equity funds. Further, broker-sold funds exhibit no more skill at aggregate-level asset allocation than do funds sold through the direct channel. Our results are consistent with two hypotheses: that brokers deliver substantial intangible benefits that we do not observe and that there are material conflicts of interest between brokers and their clients.

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