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Exchange Traded Funds: Performance and Competition

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Abstract

We study 584 domestic equity, international equity, and fixed income exchange traded funds from their inception to the end of 2007. There is enormous heterogeneity in this population in the use of different types of indices, degree of passivity, segment of the market tracked, and use of leverage. Almost 83 percent of all ETFs track indices that are not directly investable through index mutual funds, many of which represent narrow segments of the market. On average, ETFs underperform their benchmark indices and are not immune from tracking error. Only 17 percent of all ETFs directly compete with index funds; those that do, provide returns that are, for the most part, statistically indistinguishable from those provided by matched index funds. The creation of new competing ETFs reduces flows for incumbent index funds and reduces market share of incumbent ETFs in the same investment style.

Keywords: Exchange traded funds, index mutual funds, financial innovation**JEL Classification:** G23[Suggested Citation](#) >[Show Contact Information](#) >[Download This Paper \(Delivery.cfm/SSRN_ID1303643_code391889.pdf?abstractid=1303643&mirid=1\)](https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID1303643_code391889.pdf?abstractid=1303643&mirid=1)[Open PDF in Browser \(Delivery.cfm/SSRN_ID1303643_code391889.pdf?abstractid=1303643&mirid=1&type=2\)](https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID1303643_code391889.pdf?abstractid=1303643&mirid=1&type=2)

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