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Too Many Cooks Spoil the Profits: Investment Club Performance

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Abstract

We report our analysis, using account data from a large discount brokerage firm, of the common stock investment performance of 166 investment clubs from February 1991 through January 1997. The average club tilted its common stock investment toward high-beta, small-cap growth stocks and turned over 65 percent of its portfolio annually. The average club lagged the performance of a broad-based market index and the performance of individual investors. Moreover, 60 percent of the clubs underperformed the index.

The financial press has made frequent and bold claims about the performance of investment clubs. One often-quoted figure from a National Association of Investors Corporation survey states that 60 percent of investment clubs beat the market. Are these claims myth or reality?

We used account data from a large discount broker to analyze the common stock investment performance of 166 investment clubs from February 1991 to January 1997. We report that the average club earned an annualized geometric mean return of 14.1 percent whereas a market index returned 17.9 percent. In addition, 60 percent of the clubs we analyzed underperformed the index. Not only did the average club fail to beat the market, it failed to match the performance of the average individual investor, who earned 16.4 percent during our sample period.

Two reasons account for the poor performance of investment clubs relative to individual investors—trading costs and investment style. Despite having roughly similar account sizes, the clubs executed smaller trades and held more stocks than did individuals. Thus, their proportionate cost of trading was higher. Trading costs accounted for approximately one-third of the clubs' performance shortfall relative to individuals. The remaining two-thirds of the shortfall was accounted for by investment style. Relative to individuals, the clubs tilted more toward large-cap stocks and growth stocks. During our sample period, large-cap stocks underperformed small-cap stocks by 15 basis points a month and growth stocks underperformed value stocks by 20 basis points a month.

Investment clubs serve many useful functions: They encourage savings; they educate their members about financial matters; they foster friendships and social ties; and they entertain. Unfortunately, their investments do not beat the market.

Related Research Data

[Contrarian Investment, Extrapolation, and Risk](#)

Source: Unknown Repository

[The Cross-Section of Expected Stock Returns](#)

Source: The Journal of Finance

[Common risk factors in the returns on stocks and bonds](#)

Source: Journal of Financial Economics

[Do Investors Trade Too Much?](#)

Source: SSRN Electronic Journal

[Trading is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors](#)

Source: SSRN Electronic Journal

Value Versus Growth: The International Evidence

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