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Too Many Cooks Spoil the Profits: Investment Club Performance

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Abstract

We report on the performance of investment clubs, a common form of high-beta investment. The average performance of the index

The performance of investment clubs is compared to the performance of corporate investors. These clubs

We used data on investment clubs from January 1997. We report

percent whereas a market index returned 17.9 percent. In addition, 60 percent of the

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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.

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