



## Fund Tradeoffs

### 2019 AQR Insight Award Honorable Mention

We derive equilibrium relations among active mutual funds' key characteristics: fund size, expense ratio, turnover, and portfolio liquidity. Portfolio liquidity, a concept introduced here, depends not only on the liquidity of the portfolio's holdings but also on the portfolio's diversification. As our model predicts, funds with smaller size, higher expense ratios, and lower turnover hold less-liquid portfolios. Additional model predictions are also supported empirically: Larger funds are cheaper. Larger and cheaper funds trade less and are less active, based on our novel measure of activeness. Better-diversified funds hold less-liquid stocks; they are also larger, cheaper, and trade more.

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