



Measuring Managerial Skill in the Mutual Fund Industry

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Jonathan B. Berk, Ph.D., and Jules H. van Binsbergen, Ph.D.

Using the value that a mutual fund extracts from capital markets as the measure of skill, we find that the average mutual fund has used this skill to generate about \$2 million per year. We document large cross-sectional differences in skill that persist for as long as 10 years. We further document that investors recognize this skill and reward it by investing more capital with better funds. Better funds earn higher aggregate fees, and there is a strong positive correlation between current compensation and future performance. We also demonstrate why traditional measures such as the gross and net alpha fail to measure managerial skill which explains why past studies that use those measures have failed to find evidence of this skill.

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