Decimalisation hits US investors; [SURVEYS EDITION]


Abstract (Summary)
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Full Text (294 words)

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Decimalisation has carried a substantial price tag for individual US investors who buy actively managed mutual funds, according to a new study.

Pricing stocks by the cent - rather than in increments of 1/16 of a dollar - has shaved off between 1 per cent and 1.5 per cent from the average fund's annual return, says Jeffrey Busse, assistant professor of finance at Emory University's Goizueta School of Business, who co-authored the study with Nicolas Bollen of Vanderbilt University.

Before stock prices were decimalised, say the authors, marketmakers executing trades made money on the difference between the bid and ask price. Decimalisation not only lowered the money they made, but also reduced liquidity by driving marketmakers out of business.

"They used to make about 1/16 of a dollar per share," Mr Busse said.

"Now they're making as little as a penny, or one-sixth as much per round-trip transaction. With fewer people willing to make a market, the total supply of posted shares available for purchase has decreased."

The net effect is that a mutual fund ends up paying more, on average, to buy the large number of shares it typically trades. That adds to the transaction costs passed on to investors.

Index funds, by contrast, showed almost no increase in costs - 0.11 per cent. That is because index funds have lower turnover than actively managed funds and thus lower overall trading costs.

The study looked at the transaction costs of 268 mutual funds - 209 of them actively managed, 59 of them index funds - over a period starting five months before the New York Stock Exchange started phasing in decimalisation in August 2000 and ending five months after the Nasdaq finished the switch in April 2001. Lauren Foster in New York

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