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PRACTITIONER'S DIGEST

The "Practitioner's Digest" emphasizes the practical significance of manuscripts featured in the "Insights" and "Articles" sections of the journal. Readers who are interested in extracting the practical value of an article, or who are simply looking for a summary, may look to this section.

INSIGHTS

THE MARKET MAKER IN THE AGE OF THE ECN — PAGE 1

Wayne Wagner

Electronic trading venues demonstrate an impressive ability to successfully match trades with high accuracy, low cost, and at remarkable speeds. Are they on track to take over the trading process, or will there always be activities better performed by human beings?

ARTICLES

GREAT MOMENTS IN FINANCIAL ECONOMICS: III. SHORT-SALES AND STOCK PRICES — PAGE 16

Mark Rubinstein

Standard finance valuation models do not allow for short-selling restrictions or disagreement amongst investors. Considering these together can lead to significant price revisions with the potential of explaining a number of otherwise puzzling facts, including aspects of the Internet-based stock market "bubble." The history of consideration of short-selling restrictions in asset pricing models is surveyed in this paper.

MANAGED FUTURES AND HEDGE FUNDS: A MATCH MADE IN HEAVEN — PAGE 32

Harry M. Kat

Recent research has shown that the risk and dependence characteristics of hedge funds are substantially more complex than those of stocks and bonds. Although including hedge funds in a traditional investment portfolio may significantly improve that portfolio's mean-variance characteristics, it can also be expected to lead to significantly lower skewness. To neutralize this, investors might consider investing in managed futures. Managed futures programs are often trend-following in nature. By moving out of the market when it comes down, managed futures programs avoid being pulled in. As a result, the (co-)skewness characteristics of managed futures programs can be expected to be more or less opposite to those of many hedge funds. In this paper we investigate how managed futures mix with stocks, bonds and hedge funds and how they can be used to control the undesirable skewness effects that arise when adding hedge funds to portfolios of stocks and bonds. We find that managed futures combine extremely well with stocks and bonds as well as hedge funds and that the combination of managed futures and hedge funds allows investors to significantly improve the overall risk characteristics of their portfolio without, under the assumptions made, giving up much in terms of expected return.

INSTITUTIONAL MANAGEMENT FEES: ARE THE ANNUAL FEES YOU PAY FOR MONEY MANAGEMENT APPROPRIATE?

Sherry L. Jarrell and Edward S. O'Neal

In this study we analyze the determinants of institutional mutual fund expenses. We document the effect that fund characteristics have on management fees, and we interpret the economic significance of the results to allow consumers of institutional money management services to gauge whether the fees they pay are consistent with the fees on other similar alternatives. We find that a number of different characteristics affect the fees paid for institutional money management. Larger funds and larger fund families offer lower expenses. These economies of scale appear to be somewhat stronger for equity portfolios than for fixed income portfolios. Greater portfolio trading activity increases expenses for all funds, but is most pronounced for international equity funds. Actively managed funds are more expensive than index funds—23 basis points more in the case of international equity funds and 37 basis points more for domestic equity funds.

We find a definite role for investment style in driving institutional management fees. For bond funds, higher allocations to high yield securities increase expenses. Domestic equity funds exhibit expenses that increase in the allocation to small-cap and growth stocks. International equity fund expenses are highly sensitive to the allocation to emerging market securities and marginally sensitive to market capitalization.

Finally, we develop a methodology for calculating the expected expense levels for bond, domestic equity and international equity portfolios. These expected expense calculations rely on the observed relationships in our exhaustive sample of institutional mutual funds, but may be applied to separate accounts as well. Armed with these data and this methodology for calculating expected expenses, plan sponsors will be better equipped to cull appropriately priced publicly available institutional investment vehicles and to negotiate with potential providers of private money management services.

CAN SIMPLE BUY AND SELL RULES INCREASE INDEX FUTURE DAY TRADING PROFITABILITY?

Susana Yu and Joel Rentzler

Day trading index futures is popular. Two common strategies are trend-following and gap-reversal. This paper uses these strategies as "base strategies" and asks whether simple intraday exit rules can increase their profitability. Intraday stop-loss exit rules appear to add return to a trend-following base strategy of buying index futures at the opening and closing out the position at the close. There is no strong evidence that the same is true of profit-lock exit rules or that either works with a corresponding gap-reversal strategy.