

This evolution can be viewed as desirable and also as probable because it follows a pattern that has been tried and that is economical. The special character of common stocks, with their speculative attraction, will probably impede a fully parallel development. But the general direction may turn out to be the same. Problems of voting control would have to be solved, perhaps by limiting the percentage of the total votes that may be represented by mutual fund votes. This could be made to ensure any desired degree of noninstitutional stockholders' control.

At the present time, however, while already acting as important intermediaries, mutual funds are far from performing the function of reducing the turnover of primary securities. They are adding to this turnover, and are probably making the stock market less rather than more stable. This is not the pattern of the bond market. It is a very expensive way of meeting the very limited purposes it serves. In trying to create a legislative framework within which the mutual fund industry can freely evolve, thought should be given to ways in which the pattern traced successfully by the bond market can be transposed, with appropriate modifications, to the stock market.

Mr. WALLICH. I would like to say that it is a great honor to appear before this committee. I have had a practical interest as a security analyst in the stock market for something like 30 years, and from that vantage point I have the firm conviction that mutual funds are a good thing for the American people. If they didn't exist, they would have to be invented; particularly in an age of inflation, here is a way in which relatively low-income people can participate in growth, and can protect themselves against inflation. If what I am going to say may sound critical in some respects of the funds it is simply selecting some negative aspects. It does not mean that I am critical of the whole institution of mutual funds.

The areas for improvement that have been picked out by the Commission are the advisory fee, the sales load, and the front-end load. I would have a few more to add to these; for instance, the problem of whether the funds are creating an unnecessarily speculative climate.

On the advisory fee, the Commission argues that it is too high. They present data to support this. These data are controverted by the industry. As always, it is a matter of how to read statistics and what statistics to read. My judgment is that on balance the interpretation put upon the data by the Commission is much more nearly right than the interpretation put upon them by the industry, able as their presentation has been. I think the Commission is right in asserting that charges are too high.

But one can go one step further. If the charge were related to performance rather than to the mere fact that a mutual fund with diversified risk is being offered, then one ought to measure performance and see if mutual funds really do better than random selection. A good deal of evidence has accumulated lately that that is not the case. In other words, throwing darts at the stock market page on average over a period of time gives about the same results.

Now this has to be understood in a very precise way. One has to compare portfolios of the same degree of risk. It is no use comparing a portfolio of relatively stable stocks with a portfolio of high flyers. In the comparable case, the evidence seems to show, on the basis of a pretty exhaustive econometric tests, that on average in the long run mutual funds for the same risk have no better return, and for the same return have no less and often more risk, than randomly chosen portfolios.

This means that it is no use comparing mutual funds with the Dow-Jones average or any other average, because that leaves out of account