EFFECT OF TRANSACTION COSTS ON PORTFOLIO MANAGEMENT

DR. ANIRBAN GHATAK
ASSISTANT PROFESSOR,
CHRIST UNIVERSITY INSTITUTE OF MANAGEMENT,
BANGALORE

ABSTRACT
Portfolio management means implementation of the investment ideas of the portfolio managers in order to earn a profit. In doing so portfolio managers incur a cost, which is called transaction cost. Impact cost is the percentage by which the stocks are undervalued based on the bid-ask spread. This spread is caused by the transaction costs that are incurred to buy and sell securities among other factors. A sample of nifty-fifty stocks and mutual funds based on this index is considered for this study. The study shows that market capitalization, stock price levels, volumes traded and order size of the security are negatively related to impact cost and the annualized return volatility and proportion of days on which the stocks are traded as compared to the total trading days in a month are positively related to the impact cost. Tracking error of the Nifty based index funds is calculated based on the data for past 10 years. The relation between the transaction costs and tracking error was observed to be positive. This study implies that with increasing transaction cost the performance of the portfolio deviated more from the benchmark. Thus, controlling transaction cost would help to improve the performance of the fund.

KEYWORDS: Nifty-fifty, Portfolio management, Spread, Tracking Error, Transaction costs.