

Jank, Stephan

**Working Paper**

## Are there disadvantaged clienteles in mutual funds?

CFR working paper, No. 11-02

**Provided in Cooperation with:**

Centre for Financial Research (CFR), University of Cologne

Suggested Citation: Jank, Stephan (2011) : Are there disadvantaged clienteles in mutual funds?, CFR working paper, No. 11-02

This Version is available at:

<http://hdl.handle.net/10419/44966>

**Standard-Nutzungsbedingungen:**

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

**Terms of use:**

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*

**CFR-working paper NO. 11-02**

**Are there disadvantaged clienteles in  
mutual funds?**

**stephan jank**

**centre for financial research**  
Look deeper

# Are There Disadvantaged Clienteles in Mutual Funds?<sup>‡</sup>

Stephan Jank\*

## Abstract

This paper studies the flow-performance relationship of three different investor groups in mutual funds: Households, financial corporations, and insurance companies and pension funds, establishing the following findings: Financial corporations have a strong tendency to chase past performance and also hold an increased share in the top performing funds. Insurance companies and pension funds show some evidence of performance chasing, but are underrepresented in the best performing funds. Households chase performance, but they are also subject to status quo bias in their flows. Regarding investor composition the worst performing funds show no significant difference in their investor structure when compared to funds with average performance.

*Keywords:* Mutual Funds, Flow-Performance Relationship, Clientele

*JEL:* G11, G20, G23

---

<sup>‡</sup>I would like to thank the Deutsche Bundesbank, notably Matthias Schrape, for providing the data on mutual fund depositor groups. This paper was written during a visit to the Deutsche Bundesbank and I gratefully acknowledge its financial support. I thank Joachim Grammig, Alexander Kempf, Stefan Ruenzi, Erik Theissen, Martin Weber and Michael Wedow, the participants of the University of Mannheim Research Seminar on Financial Markets, the European Winter Finance Conference (EWFC) 2010 in Andermatt, the Deutsche Bundesbank Research Seminar, the CFR Colloquium on Financial Markets 2010 and the MFA Annual Meeting 2010 in Las Vegas for their comments and suggestions. All remaining errors are of course my own.

\*University of Tübingen and Centre for Financial Research (CFR), Cologne. Contact: University of Tübingen, Department of Economics, Mohlstrasse 36, D-72074 Tübingen, Germany. E-mail: [stephan.jank@uni-tuebingen.de](mailto:stephan.jank@uni-tuebingen.de)

# 1 Introduction

Mutual fund investors chase past performance, even though performance is not persistent over time. On the other hand, investors are reluctant to withdraw their money from the worst performing funds (see e.g. Sirri & Tufano 1998, Carhart 1997). This behavior has often been attributed to the irrationality of mutual fund investors.

In contrast to behavioral explanations, Gruber (1996) and Berk & Green (2004) develop a model in which investors rationally chase past performance. They assume that fund managers possess different levels of investment ability. Mutual funds' future performance is thus partly predictable from past performance. Sophisticated investors realize this and therefore rationally chase past performance. Since managerial ability is assumed to have decreasing returns to scale, a well performing manager will attract inflows until he or she is no longer able to outperform the market. By the same mechanism investors leave poorly performing funds up to the point where the funds cease to underperform. Thus, performance of mutual funds is not persistent, precisely because investors chase past performance.

The worst performing mutual funds, however, keep performing poorly (see Carhart 1997). Arguing in the framework of Gruber (1996) and Berk & Green (2004) the persistence of the worst performing funds is caused by the fact that some investors are unwilling or hindered from withdrawing their money (see Berk & Tonks 2007). This cannot be corrected by other investors, since they cannot short-sell mutual fund shares. The persistence of the worst performing funds is therefore attributed to unsophisticated or disadvantaged investor clienteles that do not withdraw their money from poorly performing funds. So are there disadvantaged clienteles in mutual funds, and if so, who are they?

Using a unique data set, that allows the identification of different investor groups in mutual funds, this paper tries to address this question. The data set comes from the Securities Deposits Statistics of the Deutsche Bundesbank, which record the depositors of securities held in Germany. Through this information I am able to obtain the investor

structure of mutual funds. In particular, the data enables me to differentiate not only between retail and institutional investors, but also between different institutional investors such as financial corporations and insurance companies and pension funds. These investor groups are likely to differ in their behavior. Financial corporations are arguably the most sophisticated investors and should invest according to performance. The group of private investors can include both sophisticated investors and unsophisticated investors. Insurance companies and pension funds are financially sophisticated, but can be institutionally disadvantaged because of regulatory restrictions. By identifying these three investor groups and analyzing their behavior within the same mutual fund I am able to directly test hypotheses deduced from the Gruber (1996) and Berk & Green (2004) model.

The main findings of this paper are as follows: First, financial corporations show a strong tendency to chase past performance, which is statistically and economically significant. The best performing funds experience inflows of up to 31 percentage points higher than the average fund. Consequently, the percentage of mutual fund shares held by financial corporations is higher for the best performing funds than for the average fund. While financial corporations hold an average of 13 percent in mutual funds, they hold about 18-19 percent in the best performing funds. The fact that financial corporations chase past performance is telling, because financial corporations are probably the most sophisticated investors and chasing past returns of mutual funds has often been attributed to unsophisticated investors. Thus, the finding that sophisticated investors chase performance provides strong support for the theory proposed by Gruber (1996) and Berk & Green (2004).

Second, there is some evidence that insurance corporations and pension funds are chasing performance, although not as strongly as financial corporations. Moreover, insurance companies and pension funds do not invest in all mutual funds in the sample. Insurance companies and pension funds tend to invest in larger and older funds, funds with high fees and less volatility, which results in the fact that insurance companies and pension

funds only hold around 10-12 percent of shares in the top performing funds, while the average share of this investor group is around 16 percent.

Third, evidence for retail investors is mixed. Households chase past winners to some extent, but compared to financial corporations the inflows to top performing funds are considerably smaller in size. Top mutual funds only experience around 3 percentage point higher inflows than the average fund. Furthermore, retail flows show a significant first-order autocorrelation, while both institutional investors - financial corporations, and insurance companies and pension funds - do not. This result is robust for all specifications and economically meaningful. All other things being equal, a fund that experienced an increase in retail flows of 10 percentage points in the previous quarter grows in the current quarter by an additional 2.6 percentage points. This autocorrelation pattern in retail flows can either be caused by unobserved fund characteristics, such as advertising and distribution channels, savings plans or by status quo bias. Both flows due to advertising and status quo bias are associated with unsophisticated investors.

Finally, the paper investigates whether investor groups differ in their behavior of punishing mutual fund managers by withdrawing their money from poorly performing funds. There is some evidence that financial corporations punish the worst performing funds by withdrawing their money. However, when looking at the percentage shares held by the investor groups, the investor composition of the worst performing funds does not systematically differ from the investor composition of the average fund.

The remainder of the paper is structured as follows. Section 2 reviews the related literature and develops the testable hypotheses. Section 3 describes the data set that is used. Section 4 investigates the differences in the flow-performance relationship of the various investor groups. Section 5 analyzes the investor composition subject to performance. Section 6 concludes.

## 2 Related Literature and Hypotheses

A wealth of literature investigates the flows of mutual fund investors as a response to past performance. This flow-performance relationship of investors in mutual funds has been found to be convex (e.g. Ippolito 1992, Chevalier & Ellison 1997, Sirri & Tufano 1998): mutual funds with high performance receive overproportional inflows, while funds with low performance experience only mild outflows. Ber, Kempf & Ruenzi (2007) and Jank & Wedow (2010) confirm this convex flow-performance relationship for the German mutual fund market.

There are several studies that investigate the flow-performance relationship of mutual funds in connection with investor heterogeneity. Christoffersen & Musto (2002) find heterogeneity among money market fund investors. On the one hand there is a group of investors that is responsive to performance; on the other there are investors that do not respond to bad performance by withdrawing their money. Investor heterogeneity can therefore explain the cross-sectional fee dispersion among money market funds.

There is also evidence for investor heterogeneity in equity funds. Del Guercio & Tkac (2002) find different flow-performance relationships among mutual and pension funds. James & Karceski (2006) observe differences between investors in institutional and retail funds and Chen, Yao & Yu (2007) find differences between the clientele of funds issued by insurance and non-insurance companies. This paper contributes to the literature of investor heterogeneity in mutual funds by directly analyzing the flow-performance relationship of various investor groups within the same fund.

The main focus of this paper thus lies in testing a theory put forth by Gruber (1996) and Berk & Green (2004). In their model they assume that mutual fund managers possess different investment abilities. Since mutual funds sell at net asset value, managerial ability is not priced. A mutual fund with high management ability is therefore underpriced. Sophisticated investors will realize this fact and buy (underpriced) well performing funds and leave underperforming funds, while disadvantaged or unsophisticated investors stay

behind. In the Berk & Green (2004) model managerial ability is subject to decreasing economies of scale (see Chen et al. 2004). Thus, inflows of sophisticated investors into top performing funds continue until the size of the fund has increased up to the point where the mutual fund manager is not expected to outperform the market. The first testable hypothesis, as formulated by Gruber, is therefore:

**Hypothesis 1:** Sophisticated investors constitute a larger percentage of cash flows into and out of mutual funds than disadvantaged investors.

If sophisticated investors identify skilled fund managers faster than unsophisticated investors and also leave poorly performing funds faster, this should also affect the stock of funds held by the investor groups. The second testable hypothesis is therefore about the percentage shares held by the different investor groups. If sophisticated investors exit poorly performing funds first, it will mostly be disadvantaged investors who stay behind. This is what Berk & Tonks (2007) call a “burnout” in analogy to the mortgage backed securities market. By the same argument the share of sophisticated investors will increase in the funds that overperform. Thus, the second testable hypothesis is twofold (Gruber 1996):

**Hypothesis 2a:** Mutual funds that overperform contain a larger proportion of sophisticated clientele than a fund with average performance.

**Hypothesis 2b:** Mutual funds that underperform contain a larger proportion of disadvantaged clientele than a fund with average performance.

This gives rise to the following question: Which groups in a mutual fund are sophisticated, unsophisticated or disadvantaged? Gruber (1996) proposes the following categorization, where mutual fund investors are divided into *sophisticated* and *disadvantaged investors*. Sophisticated investors are defined as investors who invest according to performance. The group of disadvantaged investors consists of the following sub-groups:



First, there are *unsophisticated investors*, who are influenced by other factors besides performance, such as advertising or brokerage advice. Second, there are *institutionally disadvantaged investors*, who are restricted in their investment decisions by regulations.<sup>1</sup>

This study will test these key hypotheses by investigating the flow-performance relationship and percentage holdings of three different investor groups: Households, financial corporations, and insurance companies and pension funds. If the theory by Gruber (1996) and Berk & Green (2004) is correct, we should expect differences in the investor groups' flow-performance sensitivities. Financial corporations are arguably the most sophisticated investors and should therefore have a strong flow-performance sensitivity, i.e. they should strongly chase performance and also heavily punish the worst performing funds by withdrawing money. The degree of financial sophistication for households is unclear a priori. Insurance companies and pension funds are financially sophisticated but compared to other institutional investors they are disadvantaged, because regulations restrict what they are able to invest in. In Germany insurance companies and pension funds are both regulated by the same law, the Insurance Supervision Act (Versicherungsaufsichtsgesetz, VAG), and are supervised by the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin). This regulation requires insurance companies and pension funds to verify that their investments in mutual funds comply with prudent-man principles. The three investor groups consequently differ in their decisions whether to buy and sell mutual fund shares. The following section will describe the data set used in this study.

---

<sup>1</sup>Furthermore, Gruber names tax disadvantaged investors, for whom the tax considerations make it inefficient to redeem their shares from a fund. The complication of the tax overhang caused by capital gains tax (see e.g. Barclay et al. 1998) does not apply for Germany.

## 3 Data

### 3.1 Mutual Fund Data and Depositor Structure

The sample consists of mutual funds that are registered in Germany and are thus required to report to the central bank, the Deutsche Bundesbank.<sup>2</sup> The reporting data is the main data set and contains, among other things information about the numbers of shares outstanding, total net assets, buy and sell prices and dividends paid. The data set also includes funds that have either ceased to exist or have merged with other funds and is therefore survivorship-bias free. I only consider actively managed mutual funds that are primarily offered to individuals, i.e. I omit index funds and funds that are exclusively for institutional investors. To make funds comparable I only consider funds with a sufficient number of funds in their peer group:<sup>3</sup> funds that invest in Germany, Europe and funds with a global investment objective. The information about the investment objective as well as the total expense ratio was obtained from the German Federal Association of Investment Companies (Bundesverband Deutscher Investmentgesellschaften, BVI).

The mutual fund data is matched with data from the Securities Deposits Statistics of the Deutsche Bundesbank. Starting with the last quarter of 2005 the Securities Deposits Statistics record data on the depositor structure of financial securities held in Germany. The statistics give the amount of shares held by a certain depositor group in a financial security or, in this case, in a mutual fund. I investigate three major investor groups: Households, financial corporations, and insurance corporations and pension funds. Financial corporations include credit institutions, other financial intermediaries such as investment funds and financial auxiliaries and exclude insurance corporations and pen-

---

<sup>2</sup>There are a number of funds that are registered in Luxembourg and marketed in Germany. These funds do not report to the Deutsche Bundesbank and are therefore not contained in the sample.

<sup>3</sup>I omit index funds, sector funds and foreign single-country funds.

sion funds.<sup>4</sup> For simplicity, the term financial corporations will always exclude insurance companies and pension funds in the following analysis.

The Securities Deposits Statistics collect data from financial institutions in Germany on the basis of a security-by-security reporting system. Financial institutions report the number of shares of their customers or their own holdings in a mutual fund. These shares are categorized into depositor groups by the financial institutions and then reported to the Deutsche Bundesbank, which aggregates the data for each fund. Deviations between the actual number of shares outstanding and the number of shares reported can either be caused by shares that are held by depositors which are not reported (e.g. foreign shareholders) or by double counting. For this reason I cross-check the aggregate number of shares from the deposits statistics with the number of shares outstanding. Descriptive statistics for the sample can be found in Table 1.

The table provides the number of funds in the sample and their investment objective (Germany, Europe or Global). In addition it displays statistics of common mutual fund characteristics. Finally, the table shows the number of funds for which information on the investor structure is available. Coverage of the investor structure is around 60 to 70 percent for 2005 and 2006, but improved to around 90 percent for the years 2007 and 2008. Households hold the majority of assets, but their share decreased from 71 percent in 2005 to around 58 percent at the end of 2008. We see a growing importance of institutional investors in mutual funds. Especially the group of insurance companies and pension funds increased their value-weighted shares from 13 in 2005 to 22 in 2008. This increase might reflect the fact that since the reform of the statutory pension insurance scheme in Germany in-company and private pension schemes are becoming more and more important.

---

<sup>4</sup>Categorization according to the European System of Accounts (ESA 95): Households (ESA 95 code: S.14), insurance corporations and pension funds (ESA 95 code: S.125), financial corporations include credit institutions, other financial intermediaries and financial auxiliaries (ESA 95 code: S.122, S.123 and S.124). The remaining group includes non-financial corporations, central banks, general government, and nonprofit institutions serving households (ESA 95 code: S.11, S.121, S.13 and S.15). For further details see European Commission (1996) and Deutsche Bundesbank (2006).

## 3.2 Fund Flows

Since the data provides the number of shares being held by every investor group in each quarter, the calculation of investor flows is straightforward. The net flow of depositor group  $j$  in fund  $i$  in period  $t$  is calculated as follows:

$$Flow_{i,j,t} = \frac{Shares_{i,j,t} - Shares_{i,j,t-1}}{Shares_{i,j,t-1}}, \quad (1)$$

where  $Shares_{i,j,t}$  is the amount of shares of fund  $i$  held by depositor group  $j$  in quarter  $t$ . The total net flow is simply calculated as the relative change in all outstanding shares. Through this procedure I obtain total net flows and flows for each of the three investor groups: Households, financial corporations, and insurance companies and pension funds.

Unusual flows can occur for very new funds, when mergers take place or when a fund closes down. To avoid these outliers I omit observations with a growth rate below and above the 1st and the 99th percentile.

Following Keswani & Stolin (2008) I calculate time series averages of mean, standard deviation and percentiles of all investor group flows, which can be found in Table 2. Overall, there are weak outflows from mutual funds in the sample period. While households seem to withdraw money from mutual funds in the sample period, financial corporations, and insurance companies and pension funds bought mutual fund shares. Furthermore, the cross-sectional variance of institutional flows is much larger than the variance of private investors. In particular, financial corporations show the highest variation. This high variation of institutional flows suggests that institutional investors move their money more quickly into and out of mutual funds than retail investors do.

Table 3 shows time series averages of pairwise correlations of investor group flows. The average correlation between the flows of the different groups is surprisingly small. Keswani & Stolin (2008) find a similarly low correlation between retail and institutional investors. This low correlation points to the fact that different investor groups behave very differently when deciding whether to buy and sell funds.

### 3.3 Performance Measures

Performance is estimated using three measures, which are commonly reported for mutual funds: Raw Return, Sharpe Ratio and Jensen's Alpha. Raw Returns are calculated assuming that gross dividends are reinvested immediately. I calculate the Sharpe Ratio as the average excess return in the evaluation period divided by the variance of returns (Sharpe 1966):

$$Sharpe\ Ratio_i = \frac{\overline{R_i - R^f}}{\sqrt{Var(R_i)}}, \quad (2)$$

where  $R_i$  is the monthly return of fund  $i$  and  $R^f$  the risk free rate measured by the 1-month EURIBOR. Last, I use the performance measure proposed by Jensen (1968). Jensen's Alpha is estimated as follows:

$$R_i - R^f = \alpha_i + \beta_i(R^m - R^f), \quad (3)$$

where  $R_i$  is again the return of fund  $i$  and  $R^f$  the risk free rate, again measured by the 1-month EURIBOR, and  $R^m$  is the return of the market portfolio. The market portfolio return is measured by the benchmark index for each investment objective. I use the following three benchmark indices, which are generally used to evaluate these mutual funds in their respective peer group: the MSCI Germany, MSCI Europe and MSCI Global Index. The evaluation period for the performance measures is 24 months. Using shorter or longer evaluation periods, such as 12 and 36 months, leads to similar results.

This study focuses on these performance measures, because they are easily available for all investors. Information services such as Morningstar and others provide these on a regular basis. The performance measures provided can therefore be seen as a signal of managerial ability, which is available to *all* investors, institutional and private, at no or only negligible costs. Thus, the focus of this paper is to answer the question of how investors react to these observed performance measures by adjusting their flows.

## 4 Flow-Performance Relationship

### 4.1 Flow-Performance Relationship of Different Investor Groups

In order to estimate the flow-performance relationship I run a piecewise-linear regression (see Sirri & Tufano 1998, Huang et al. 2007). For each quarter mutual funds are ranked within their investment objective according to their past performance, where performance is measured by Raw Return, Sharpe Ratio and Jensen's Alpha over the past 24 months. This rank is then normalized so that ranks are evenly distributed between zero and one, where zero is assigned to the worst performing fund and one to the best performing fund. Funds are then categorized into low, medium and high performing funds: low performing funds include the lowest performance quintile, medium performing funds the three middle performance quintiles and the high performing funds the highest performance quintile. The three variables for the regression are defined in the following way:

$$\begin{aligned} Low_i &= Min(Rank_i, 0.20) \\ Mid_i &= Min(Rank_i - Low_i, 0.60) \\ High_i &= Rank_i - Mid_i - Low_i, \end{aligned} \tag{4}$$

where  $Rank_i$  is the percentile rank of the fund. Thus, the coefficients of  $Low$ ,  $Mid$  and  $High$  represent the piecewise decomposition of the percentile rank and can be interpreted as the slope of the flow-performance relationship within the performance range. The regression model is specified as follows:

$$\begin{aligned} Flow_{i,j,t} &= \beta_0 + \beta_1 Low_{i,t-1} + \beta_2 Mid_{i,t-1} + \beta_3 High_{i,t-1} \\ &+ \beta_4 Controls_{i,t-1} + \varepsilon_{i,j,t}, \end{aligned} \tag{5}$$

where  $Flow_{i,j,t}$  is the flow of each investor group  $j$  in fund  $i$  at quarter  $t$ . Control variables include volatility measured by the 24-month standard deviation of monthly

returns, total expenses, fund size measured by the natural logarithm of total net assets, and fund age measured by the natural logarithm of one plus age in years.<sup>5</sup> For each investor group I also include the flow lagged by one quarter into the regression, since mutual fund flows show a pattern of autocorrelation. In addition, the regression includes time dummies and dummies for the investment objectives, which are not reported.

The quarterly regression model is estimated using pooled OLS, since the sample's time dimension is quite short and the Fama & MacBeth (1973) regression lacks sufficient statistical power in such a setting. Standard errors are clustered at the fund level.

Table 4 shows the result of this regression for Raw Return, Sharpe Ratio and Jensen's Alpha. For all performance measures I find a convex flow-performance relationship in total net flows as can be seen in the first column of Panel A, B and C. Furthermore, the results show significant first-order autocorrelation in mutual fund flows. The remaining control variables show the expected signs. Volatility in returns is negatively related to fund flows, even though only significant in one specification and total fees are also negatively related to flows. Size and age have no significant influence on flows at the aggregate level. These findings are comparable to those for the US market (see e.g. Sirri & Tufano 1998, Chen et al. 2007, Huang et al. 2007).

Looking at the disaggregate flows, however, the three investor groups show pronounced differences in their flow-performance relationship in the high segment. Financial corporations have the highest flow-performance sensitivity in this segment. The top performing funds experience a 31 percentage point higher growth rate than funds in the middle section (See Panel B). There is some evidence that the group of insurance companies and pension funds chases past performance, but the coefficient of the high segment is not statistically significant for all performance measures. Moreover, households chase past performance, although, the coefficient is much smaller in size.

---

<sup>5</sup>Total expenses are measured by expense ratio + 1/3 total load. Since the average holding period was 2 - 3 years in the sample I adjust the calculation of total fees as proposed by Sirri & Tufano (1998). Note that Barber et al. (2005) find similar results for US mutual funds with an average holding period of 30 months in the late 1990s.

The first-order autocorrelation of investor flows is also of interest. The positive autocorrelation found in the aggregate net flows of mutual funds can solely be attributed to the group of households. Insurance companies and pension funds show no significant autocorrelation and financial corporations show a slightly negative coefficient of lagged flows, which, however, is only significantly different from zero at a ten percent level. This result is robust for all specifications and economically meaningful. All other things being equal, a fund that experienced an increase in retail flows of 10 percentage points in the previous quarter grows in the current quarter by an additional 2.6 percentage points. The autocorrelation in retail flows can be explained by unobserved factors such as distribution channels of the fund family, advertising or simply status quo bias (see e.g. Patel et al. 1991, Goetzmann & Peles 1997, Kempf & Ruenzi 2006). Thus, the autocorrelation of retail flows is a sign for unsophisticated investors among the group of retail investors. An alternative explanation is that retail investors are disadvantaged through high transaction costs, and thus choose to invest continuously in the same fund (e.g. through a savings plan).

The convex flow-performance relationship in total flows can be seen by the fact that withdrawals in the low performance segment are not as strong as performance chasing in the high performance segment. In addition, when comparing the three investor groups, differences in flow-performance sensitivity in the low performance segment are not as pronounced as for the high performance segment. Only financial corporations show significant outflows from the worst performing funds, when using risk adjusted performance measures. These findings have to be interpreted with caution since the flows of institutional investors show a high variation and these results might be driven by rather extreme flows.

In summary, the results mainly support the first hypothesis. Sophisticated investors account for a larger percentage of cash flows into well performing funds than disadvantaged investors do. Financial corporations, arguably the most sophisticated investors, chase past performance to the greatest extent. Insurance companies and pension funds, a group of



investors that might be institutionally disadvantaged, show a lower tendency to chase past performance. The results of households as a group are mixed. On the one hand they seem to be sophisticated, on the other hand some flows seem to be driven by advertising or status quo bias. This result is in line with Malloy & Zhu (2004), who find clientele differences among retail investors. There is some evidence that financial corporations punish poor performance by withdrawing their money from low performing funds.

As we see in Table 4, insurance companies and pension funds do not invest in all mutual funds of the sample. They invest only in 968 out of 1350 funds, which is about 71 percent of the sample. Omitting this fact might bias the results of the flow-performance relationship. To address this potential selection bias I will model both the decision to invest in a fund or not and the decision regarding how much to invest in the fund (flow regression) simultaneously in the next section using a Heckman selection model.<sup>6</sup>

## **4.2 The Investment Decisions of Insurance Companies and Pension Funds**

The investment decisions of insurance companies and pension funds are different to those of households and financial corporations. While financial corporations and households can decide on their own, insurance companies and pension funds are regulated by the Federal Financial Supervisory Authority (BaFin) and have to prove that their investments in mutual funds comply with prudent-man principles. If these principles are violated, insurance companies and pension funds are not allowed to invest in the fund. This regulation might be the reason why there are no insurances and pension funds in one third of the funds in the sample. Thus, the decision of insurance companies and pension funds is twofold: first, whether they can invest in the fund or not; and second, how much they invest in the funds they are allowed to invest in.

---

<sup>6</sup>I also run a Heckman selection model for the group of financial corporations as a robustness check. The results of the Heckman model are very similar to the pooled OLS approach. The Heckman selection model is not feasible for households, since the number of funds that lack private investors is not sufficient.

To capture this two-part decision process I run a Heckman (1979) selection model. The flow-performance regression for insurance companies and pension funds is specified as before:

$$\begin{aligned} Flow_{i,j,t} = & \beta_0 + \beta_1 Low_{i,t-1} + \beta_2 Mid_{i,t-1} + \beta_3 High_{i,t-1} \\ & + \beta_4 Controls_{i,t-1} + \varepsilon_{1,i,j,t}, \end{aligned} \quad (6)$$

however, flows are only observed if insurance companies and pension funds decided to invest in the mutual fund or are not restricted from investing in this fund. This is the case if the following condition is fulfilled:

$$\gamma_0 + \gamma_1 Performance Rank_{i,t-1} + \gamma_2 Controls_{i,t-1} + \varepsilon_{2,i,j,t} > 0, \quad (7)$$

where

$$\varepsilon_1 \sim N(0, \sigma)$$

$$\varepsilon_2 \sim N(0, 1)$$

$$Corr(\varepsilon_1, \varepsilon_2) = \rho.$$

The explanatory variables of the selection equation are past performance, measured by the performance ranking over an evaluation period of 24 months, volatility also measured over the past 24 months, and the age and size of the fund. Furthermore, dummy variables indicating the investment objective and time dummies are included, but not reported. I estimate the Heckman two equation model using maximum likelihood. Results for the three different performance measures are displayed in Table 5.

The first column of each specification (FLOW) shows the flow-performance relationship already estimated (Eq. 6). The second column of each specification (SELECT) displays the results of the selection equation, the decision of the insurance companies and pension funds on whether to invest in the fund (Eq. 7). The estimation results are

virtually the same as before. Insurance companies and pension funds show a tendency to chase past performance, although not for all performance measures.

In the Heckman selection model a self-selection bias arises only if the correlation  $\rho$  between the residuals of equation (6) and (7) is not equal to zero. As can be seen from Table 5, the null hypothesis that  $\rho$  is equal to zero cannot be rejected on all conventional significance levels. Thus, a separate estimation, as carried out before, delivers already unbiased estimates.

Nevertheless, the selection equation provides some interesting insights. The probability of insurance companies and pension funds investing in a mutual fund decreases if the fund is a high performer. This result is in line with the avoidance of risk required by the prudent-man principles. High volatility, on the other hand, has no significant effect on the probability of insurance companies and pension funds investing in mutual funds. Moreover, insurance companies and pension funds tend to invest in older and larger funds, which can be interpreted as the fund having a long and good reputation, but it should also be borne in mind that only a long record makes it possible for insurance companies and pension funds to provide evidence of the security of the mutual fund to the regulator. The positive coefficient for fund fees might also indicate that insurance companies and pension funds see these funds as high quality funds. Or to put it differently: a high quality fund, which has maybe even received a quality rating, is simply able to charge a higher fee.

To quantify the effect of the explanatory variables on the probability of insurance companies and pension funds investing in a mutual fund I provide marginal effects of a Probit model. Since the residuals of the flow regression are uncorrelated with the residuals of the selection regression, a two-part model, i.e. separately running a Probit model and OLS regression, also yields unbiased results. Table 6 reports the marginal effects of the Probit model evaluated at the mean of the explanatory variables.

In summary, insurance companies show signs of performance chasing, although regulations seem to hinder them from investing in all mutual funds. Overall, the disaggregation

of the flow-performance relationship in their investor types supports the theory of Gruber (1996) and Berk & Green (2004); however, the results provide no clear-cut evidence of whether one group is punishing bad performance more severely. Only in some specifications do financial corporations show a significant flow-performance relationship in the lower segment. These results should be interpreted with caution since the fund flows, especially institutional flows, show very extreme values (see Table 2). The results of the flow-performance regression could accordingly be driven by a few extreme flows. Therefore, in the next section I will analyze the percentage holdings of investors. A difference in the flow-performance relationship should also become apparent in the stock of shares held by the different investor groups.

## 5 Mutual Fund Investor Composition

### 5.1 Investor Composition by Quintile

If all investors react in the same way to performance there should be no systematic difference in the percentage of shares held by investor groups in well or poorly performing funds. In contrast, if there are sophisticated investors and disadvantaged investors, the investor compositions for well and poorly performing funds should be different. Sophisticated investors learn about managerial ability and will increase their flows into high performing funds, which should consequently increase the percentage of shares held by sophisticated investors in top performing funds. By the same token there should be an increased percentage of disadvantaged investors in the worst performing funds.

In order to test this hypothesis I rank mutual funds according to their past performance within their investment objective and form five quintiles. In each quintile I determine the average size measured by the total net assets (TNA) of the fund and the average share of each investor group. The results can be found in Table 7. The difference in means between the groups is tested using a t-test. I test the differences between the top and bottom quintile (5-1), the 5th and 4th quintile (5-4) and the 2nd and 1st quintile (2-1).

The worst performing funds (bottom quintile) are much smaller on average than the better performing funds. Fund size increases with performance, but the top performing funds are slightly smaller on average than the fourth quintile in two out of three cases. This result is in line with the theoretical model by Berk & Green (2004), who argue that there are economies of scale in managerial ability.

The percentage share held by households is slightly higher for the worst performing funds than the top performing funds. This finding is in line with the previous results. Households do chase returns to some extent, but, in addition, other factors such as advertising might play an important role in the fund selection process.

The previous finding for financial corporations can also be confirmed. Financial corporations show the strongest tendency to chase past performance. The share of financial corporations in the top performing funds is therefore 19 while the worst performing funds only contain 13 percent on average (Panel A). Moreover, the difference between the top quintile and the second best quintile is distinct. The share of financial corporations increases by 6 percentage points from the 4th to the 5th quintile.

The group of insurance corporations and pension funds is clearly underrepresented in the top performing funds, even though there is some evidence of performance chasing for this investor group. Insurance companies and pension funds do not hold any shares in many of the better performing funds, which results in the large difference in means between the top two and the bottom three quintiles.

While this test shows distinct differences in investor composition between top performing funds and average funds, there is no clear difference between the worst performing funds and average funds. Even though the average size of mutual funds decreases from 260 million to 182 million Euro from the second to the first quintile (Panel A), the investor composition between the second and first quintile does not change considerably. Only the difference in mean shares for households is statistically significant, when comparing the second versus the first quintile. However, when testing against the 3rd or 4th quintile this difference becomes insignificant (not reported). This result implies that the speed with

which households, financial corporations, and insurance companies and pension funds leave the worst performing funds does not differ significantly.

## 5.2 Investor Composition: Robustness Checks

Since other factors might influence the percentage share held by one investor group I run a multivariate regression as a robustness check. I construct a dummy variable *Quintile 1* that is one if the fund's performance is in the first quintile and zero otherwise. Dummies for the other quintiles are constructed in the same way.

Table 1 shows that the holding structure of mutual fund investors changed over time. To account for the changing investor composition over time, I include time dummies as a control in the regression. Furthermore, different investor groups might have different preferences regarding the investment objective of the fund. This is controlled for by also including dummies for the fund investment objective. Additional controls are the funds' volatility, fees, size and age.

I run a regression of percentage shares of investor groups on the quintile dummies and the mentioned controls. The omitted category is the 3rd quintile. Thus, the coefficients of the dummy variables measure the difference relative to a fund with average performance. The results are essentially the same as for the univariate test. Most importantly, financial corporations hold a significantly higher share in the top performing funds than a fund with average performance. The composition of the worst performing funds, in contrast, does not systematically differ from the investor composition of the average fund. The finding of the flow-performance regression that financial corporations punish poorly performing funds more quickly is not confirmed when looking at the investor compositions. The significant flow-performance relationship in the low segment is thus most likely driven by only a few observations.

Furthermore, financial corporations seem to be less risk averse since their share is greater in funds with higher volatility. In addition, younger funds have an increased share of financial corporations as investors. One possible explanation is that financial corpo-

rations have better inside knowledge about the fund manager’s ability and are therefore willing to buy younger funds.

Looking at the investor composition of mutual funds provides an additional test for the theory of Gruber (1996) and Berk & Green (2004). While this test provides evidence that sophisticated investors hold higher percentage shares in the best performing funds, the test cannot detect any systematic difference in investor composition between the worst performing funds and those with average performance. Thus, we do not observe a “burnout”, where sophisticated investors exit poorly performing funds first and only disadvantaged and unsophisticated investors stay behind. The results are more in line with Lynch & Musto (2003), who argue that investors do not respond to poor performance, because they expect the management strategy or the management team to change.

## 6 Conclusion

Chasing past performance of mutual funds is often explained by asymmetric information or behavioral arguments. Gruber (1996) and Berk & Green (2004) provide an alternative explanation for this phenomenon. Sophisticated investors *rationaly* chase past performance, because high past performance is a signal for managerial ability.

This paper provides a direct test of this theory by examining the flow-performance relationship of different investor groups in German mutual funds. The findings overall support the theory of Gruber (1996) and Berk & Green (2004). Financial corporations, arguably the most sophisticated investor group, have a strong tendency to chase past performance. The group of households comprises both sophisticated investors, who chase past performance, and unsophisticated investors, whose investment decision is driven by advertising or status quo bias. Insurance companies and pension funds show signs of being institutionally disadvantaged. There is some evidence that this investor group chases past performance, but they are underrepresented in the best performing funds, probably due to investment restrictions. Surprisingly, I find no significant difference between the

investor composition of the worst performing funds and those with average performance. These results provide new insights into the investment decisions of different mutual fund investors and the different flow-performance relationships of investor groups.



## References

- Barber, B. M., Odean, T. & Zheng, L. (2005), ‘Out of Sight, Out of Mind: The Effects of Expenses on Mutual Fund Flows’, *The Journal of Business* **78**(6), 2095–2120.
- Barclay, M., Pearson, N. & Weisbach, M. (1998), ‘Open-end Mutual Funds and Capital-gains Taxes’, *Journal of Financial Economics* **49**(1), 3–43.
- Ber, S., Kempf, A. & Ruenzi, S. (2007), ‘Determinanten der Mittelzuflüsse bei deutschen Aktienfonds’, *Zeitschrift für betriebswirtschaftliche Forschung* **59**(2), 35–60.
- Berk, J. B. & Tonks, I. (2007), ‘Return Persistence and Fund Flows in the Worst Performing Mutual Funds’, *NBER Working Papers* .
- Berk, J. & Green, R. (2004), ‘Mutual Fund Flows and Performance in Rational Markets’, *Journal of Political Economy* **112**(6), 1269–1295.
- Carhart, M. M. (1997), ‘On Persistence in Mutual Fund Performance’, *The Journal of Finance* **52**(1), 57–82.
- Chen, J., Hong, H., Huang, M. & Kubik, J. (2004), ‘Does Fund Size Erode Mutual Fund Performance? The Role of Liquidity and Organization’, *American Economic Review* **94**(5), 1276–1302.
- Chen, X., Yao, T. & Yu, T. (2007), ‘Prudent Man or Agency Problem? On the Performance of Insurance Mutual Funds’, *Journal of Financial Intermediation* **16**(2), 175 – 203.
- Chevalier, J. & Ellison, G. (1997), ‘Risk Taking by Mutual Funds as a Response to Incentives’, *Journal of Political Economy* **105**(6), 1167–1200.
- Christoffersen, S. & Musto, D. (2002), ‘Demand Curves and the Pricing of Money Management’, *Review of Financial Studies* **15**(5), 1499–1524.
- Del Guercio, D. & Tkac, P. A. (2002), ‘The Determinants of the Flow of Funds of Managed Portfolios: Mutual Funds vs. Pension Funds’, *Journal of Financial & Quantitative Analysis* **37**(4), 523 – 557.
- Deutsche Bundesbank (2006), ‘Securities Deposits Statistic: Guidelines and Explanatory Notes on the Institutions’ Reports’.
- European Commission (1996), ‘European System of Accounts ESA 1995’, *Eurostat* . Brussels-Luxembourg.

- Fama, E. & MacBeth, J. (1973), ‘Risk, Return, and Equilibrium: Empirical Tests’, *Journal of Political Economy* **81**(3), 607.
- Goetzmann, W. & Peles, N. (1997), ‘Cognitive Dissonance and Mutual Fund Investors’, *Journal of Financial Research* **20**, 145–158.
- Gruber, M. (1996), ‘Another Puzzle: The Growth in Activity Managed Mutual Funds.’, *Journal of Finance* **51**(3), 783–810.
- Heckman, J. J. (1979), ‘Sample Selection Bias as a Specification Error’, *Econometrica* **47**(1), 153–161.
- Huang, J., Wei, K. D. & Yan, H. (2007), ‘Participation Costs and the Sensitivity of Fund Flows to Past Performance’, *Journal of Finance* **62**(3), 1273 – 1311.
- Ippolito, R. (1992), ‘Consumer Reaction to Measures of Poor Quality: Evidence from the Mutual Fund Industry’, *Journal of Law and Economics* **35**, 45 – 70.
- James, C. & Karceski, J. (2006), ‘Investor Monitoring and Differences in Mutual Fund Performance’, *Journal of Banking & Finance* **30**(10), 2787 – 2808.
- Jank, S. & Wedow, M. (2010), ‘Purchase and Redemption Decisions of Mutual Fund Investors and the Role of Fund Families’, *Deutsche Bundesbank Discussion Paper Series 2* **03/10**.
- Jensen, M. C. (1968), ‘The Performance of Mutual Funds in the Period 1945-1964’, *The Journal of Finance* **23**(2), 389–416.
- Kempf, A. & Ruenzi, S. (2006), ‘Status Quo Bias and the Number of Alternatives: An Empirical Illustration from the Mutual Fund Industry’, *Journal of Behavioral Finance* **7**(4), 204–213.
- Keswani, A. & Stolin, D. (2008), ‘Which Money Is Smart? Mutual Fund Buys and Sells of Individual and Institutional Investors’, *The Journal of Finance* **63**(1), 85–118.
- Lynch, A. & Musto, D. (2003), ‘How Investors Interpret Past Fund Returns’, *The Journal of Finance* **58**(5), 2033–2058.
- Malloy, C. & Zhu, N. (2004), ‘Mutual Fund Choices and Investor Demographics’, *Working Paper* .
- Patel, J., Zeckhauser, R. & Hendricks, D. (1991), ‘The Rationality Struggle: Illustrations from Financial Markets’, *The American Economic Review* **81**(2), 232–236.

Sharpe, W. F. (1966), 'Mutual Fund Performance', *The Journal of Business* **39**(1), 119–138.

Sirri, E. & Tufano, P. (1998), 'Costly Search and Mutual Fund Flows', *The Journal of Finance* **53**(5), 1589–1622.

**Table 1: Sample Summary Statistics**

This table shows summary statistics of the mutual fund data set at the end of each year. First, it shows the total number of funds and the number of funds in each investment objective (Germany, Europe and Global). Second, it shows other averages of mutual fund characteristics: TNA are the total net assets in million Euro. Expense ratio is the average expenses per year divided by average total net assets. Total load includes front-end and back-end loads. Age is the age since inception in years. Return is the 12-month return in percent. The standard deviation is calculated using monthly returns from the past 12 months. Third, it displays the number of funds with depositor information available and the value-weighted percentage shares by the depositor groups (Households, Financial Corporations, Insurance Companies and Pension Funds and Other Investors).

Year	2005	2006	2007	2008
Total	239	246	247	243
Germany	50	52	50	46
Europe	106	108	111	109
Global	83	86	86	88
TNA (Million EUR)	328.9	357.9	358.8	197.3
Expense Ratio (%)	1.42	1.35	1.37	1.40
Total Load (%)	4.08	3.87	3.98	3.94
Age (Years)	11.53	11.83	12.30	12.48
Return (%)	24.06	15.30	4.52	-37.94
Std. Deviation (monthly returns)	3.39	2.98	3.02	5.93
Funds with Depositor Information	159	172	221	225
Coverage (%)	66.5	69.9	89.5	92.6
Households (%)	70.9	64.4	59.2	58.1
Financial Corporations (%)	11.3	17.0	14.3	14.2
Insurance companies and Pension Funds (%)	12.7	12.3	19.7	22.0
Other (%)	5.1	6.3	6.8	5.7

**Table 2: Descriptive Statistics of Investor Flows**

This table shows descriptive statistics of quarterly flows by investor type. Flows are the change in shares as a percentage of the number of shares held in the previous period. All reported measures are time series averages of the cross-sectional measures.

	Mean	Std. Dev.	Percentiles				
			10th	25th	50th	75th	90th
Total	-2.41	10.88	-11.92	-6.18	-2.63	0.06	6.40
Households	-3.30	8.50	-10.53	-5.96	-3.66	-1.21	2.94
Financial Corporations	10.00	80.29	-36.83	-13.03	-1.60	6.83	44.96
Insurance Companies and Pension Funds	3.63	38.53	-6.19	-0.13	0.71	3.81	13.58

**Table 3: Correlations between Investor Flows**

This table shows time series averages of pairwise correlation coefficients between total flows and flows of different investor groups. Flows are the change in shares as a percentage of the number of shares held in the previous period.

	Total	Households	Financial Corporations	Insur. Companies and Pension Funds
Total	1.000			
Households	0.554	1.000		
Financial Corporations	0.363	0.075	1.000	
Insurance Companies and Pension Funds	0.200	0.044	0.049	1.000

**Table 4: Flow-Performance Relationship**

This table shows the effect of past performance on total net flows and net flows separated by investor type. All explanatory variables are lagged and, in addition, the regression includes time dummies and dummies for the investment objective, which are not reported. Performance is measured by Raw Return, Sharpe Ratio and Jensen's Alpha (Panel A, B and C) calculated over the past 24 months. Quarterly flows are regressed on low, mid and high performance ranges and controls. Lagged flow is the flow of the previous quarter, volatility is measured as the standard deviation over the performance evaluation period, total fee is the expense ratio plus 1/3 of total loads, size is measured by the natural logarithm of assets and age is the natural logarithm of one plus age in years. Robust standard errors clustered at the fund level are given in parentheses. \*, \*\*, and \*\*\* indicate significance at the 10%, 5% and 1% level respectively.

<b>Panel A: Raw Return</b>				
	Total	Households	Financial Corporations	Insur. Companies & Pension Funds
Low	18.00*** (6.86)	4.80 (5.29)	33.36 (37.62)	33.80 (24.54)
Mid	-1.15 (1.57)	0.66 (1.40)	-0.72 (11.75)	-3.08 (4.68)
High	37.79*** (12.84)	15.72** (7.42)	120.45* (68.01)	80.17** (39.36)
Lagged Flow	0.13*** (0.05)	0.26*** (0.07)	-0.06* (0.03)	0.05 (0.04)
Volatility	-1.39* (0.84)	-0.64 (0.76)	-5.04 (3.50)	-2.81 (3.40)
Total Fee	-1.49*** (0.57)	-0.95** (0.40)	-4.84 (3.47)	1.59 (2.16)
Size	-0.11 (0.23)	-0.04 (0.16)	-1.25 (1.40)	0.30 (1.10)
Age	0.52 (0.62)	0.11 (0.48)	-1.00 (4.14)	-2.59 (2.08)
Constant	5.21 (5.23)	4.67 (5.04)	73.28* (42.28)	1.24 (23.26)
Observations	1350	1317	1262	968
R-squared	0.094	0.125	0.021	0.043

(continued)

**Table 4** -Continued

<b>Panel B: Sharpe Ratio</b>				
	Total	Households	Financial Corporations	Insur. Companies & Pension Funds
Low	18.03*** (6.41)	7.17 (4.50)	106.90** (48.54)	33.91 (26.08)
Mid	-1.15 (1.56)	0.17 (1.27)	-23.13 (14.65)	-5.29 (6.21)
High	34.19*** (11.11)	17.50** (7.24)	157.21** (66.40)	33.90 (28.99)
Lagged Flow	0.14*** (0.05)	0.26*** (0.07)	-0.06* (0.03)	0.05 (0.04)
Volatility	-0.31 (0.84)	-0.04 (0.67)	-1.28 (3.60)	-1.26 (3.34)
Total Fee	-1.35** (0.57)	-0.89** (0.40)	-4.67 (3.47)	1.81 (2.23)
Size	-0.07 (0.23)	-0.03 (0.15)	-0.94 (1.38)	0.70 (1.02)
Age	0.41 (0.61)	0.09 (0.47)	-1.31 (4.10)	-3.18 (2.04)
Constant	0.83 (4.98)	0.96 (4.58)	40.16 (41.18)	-9.54 (22.06)
Observations	1350	1317	1262	968
R-squared	0.093	0.128	0.024	0.037

(continued)

Table 4 -Continued

<b>Panel C: Jensen's Alpha</b>				
	Total	Households	Financial Corporations	Insur. Companies & Pension Funds
Low	16.35** (6.69)	4.61 (4.98)	91.13** (42.98)	28.02 (30.59)
Mid	-0.50 (1.48)	0.30 (1.27)	-17.72 (14.55)	-7.94 (8.11)
High	27.47** (10.59)	17.26** (6.80)	124.01** (53.91)	42.41* (23.86)
Lagged Flow	0.14*** (0.05)	0.26*** (0.07)	-0.06* (0.03)	0.05 (0.04)
Volatility	-0.62 (0.83)	-0.29 (0.70)	-2.28 (3.28)	-1.64 (3.38)
Total Fee	-1.47*** (0.56)	-0.97** (0.40)	-5.13 (3.62)	1.51 (2.32)
Size	-0.05 (0.23)	-0.02 (0.15)	-0.88 (1.37)	0.78 (0.98)
Age	0.35 (0.62)	0.12 (0.48)	-1.63 (4.16)	-3.03 (2.03)
Constant	2.24 (5.28)	2.63 (4.89)	48.84 (40.71)	-7.63 (20.99)
Observations	1350	1317	1262	968
R-squared	0.087	0.127	0.021	0.037



**Table 5: The Investment Decisions of Insurance Companies and Pension Funds**

This table shows the investment decision of insurance companies and pension funds estimated using a Heckman selection model. The column FLOW indicates the flow-performance regression, where flows of insurance companies and pension funds are regressed on performance measures (Low, Mid and High) and controls. The control variables are defined as before (see Table 4). SELECT indicates the selection equation that models whether insurances and pension funds decide to invest in a fund or not. Explanatory variables for the selection equation are performance measured by the percentile rank and the control variables as before. The model is estimated by maximum likelihood. Robust standard errors clustered at the fund level are given in parentheses. \*, \*\*, and \*\*\* indicate significance at the 10%, 5% and 1% level respectively.

	Raw Return		Sharpe Ratio		Jensen's Alpha	
	FLOW	SELECT	FLOW	SELECT	FLOW	SELECT
Low	33.80 (24.28)		33.92 (25.81)		28.05 (30.30)	
Mid	-3.05 (4.61)		-5.22 (6.10)		-7.86 (7.94)	
High	80.14** (38.95)		33.91 (28.69)		42.38* (23.59)	
Performance Rank		-0.46*** (0.17)		-0.52*** (0.18)		-0.55*** (0.17)
Lagged Flow	0.05 (0.04)		0.05 (0.04)		0.05 (0.04)	
Volatility	-2.81 (3.37)	-0.12 (0.13)	-1.24 (3.30)	-0.20 (0.13)	-1.62 (3.35)	-0.19 (0.13)
Total Fee	1.57 (2.21)	0.66*** (0.11)	1.73 (2.27)	0.64*** (0.11)	1.43 (2.37)	0.65*** (0.11)
Size	0.28 (1.12)	0.40*** (0.04)	0.67 (1.04)	0.40*** (0.04)	0.74 (1.00)	0.40*** (0.04)
Age	-2.59 (2.05)	0.27*** (0.10)	-3.20 (2.01)	0.27*** (0.10)	-3.05 (2.00)	0.27*** (0.10)
Constant	1.60 (23.80)	-8.39*** (1.03)	-8.66 (22.53)	-8.12*** (1.03)	-6.65 (21.53)	-8.15*** (1.03)
$\lambda = \rho\sigma$		-0.11 (0.80)		-0.26 (0.76)		-0.29 (0.81)
Observations		1350		1350		1350
Log Likelihood		-5444		-5445		-5445
Wald test: $\rho = 0$		0.02		0.13		0.15
p-value		0.89		0.72		0.70

**Table 6: The Investment Decisions of Insurance Companies and Pension Funds: Probit-Model**

This table shows the marginal effects of a Probit regression of the decision whether insurance companies and pension funds invest in a mutual fund or not. The dependent variable is a dummy that is one if insurance companies and pension funds invested in the mutual fund and zero otherwise. Explanatory variables are defined as before (see Table 4). Marginal effects are evaluated at the mean. Robust standard errors clustered at the fund level are given in parentheses. \*, \*\*, and \*\*\* indicate significance at the 10%, 5% and 1% level respectively.

	<b>Raw Return</b>	<b>Sharpe Ratio</b>	<b>Jensen's Alpha</b>
Performance Rank	-0.11 (0.08)	-0.12 (0.08)	-0.13* (0.07)
Volatility	-0.03 (0.06)	-0.05 (0.06)	-0.05 (0.06)
Total Fee	0.18*** (0.05)	0.18*** (0.05)	0.18*** (0.05)
Size	0.11*** (0.02)	0.11*** (0.02)	0.11*** (0.02)
Age	0.07 (0.06)	0.07 (0.06)	0.07 (0.06)
Observations	1350	1350	1350

**Table 7: Investor Composition by Performance**

This table shows the average total net assets in million EUR (TNA) and the average share (as percentage of total net assets) held by the three major investor groups. Funds were ranked within their investment objective into quintiles by their prior 24-month Raw Return, Sharpe Ratio and Jensen's Alpha. Total net assets are measured in million Euro, shares of the investor groups are in percent. Moreover, the table displays the total average over the whole sample. In addition, it provides the differences in means between the 5th and 1st quintile (5-1), the 5th and 4th quintile (5-4) and the 2nd and 1st quintile (2-1). The p-values of a t-test of equality in means are given in parentheses.

---



---

**Panel A: Raw Return**

---

	TNA	Households	Financial Corporations	Insur. Companies & Pension Funds
1 (Bottom)	182.7	66.3	10.8	17.3
2	259.6	61.7	9.7	19.7
3	490.7	65.2	11.9	15.9
4	593.7	67.3	12.8	13.2
5 (Top)	414.0	58.8	19.2	11.8
Total	390.2	64.0	12.8	15.6
5-1:	231.3 (0.000)	-7.6 (0.000)	8.4 (0.000)	-5.5 (0.003)
5-4:	-179.7 (0.008)	-8.5 (0.000)	6.4 (0.000)	-1.4 (0.428)
2-1:	76.9 (0.042)	-4.7 (0.046)	-1.1 (0.443)	2.4 (0.255)

---



---

(continued)

**Table 7** -Continued

<b>Panel B: Sharpe Ratio</b>				
	TNA	Households	Financial Corporations	Insur. Companies & Pension Funds
1 (Bottom)	177.3	66.5	11.1	16.1
2	261.4	61.5	10.9	19.7
3	507.1	65.3	11.4	17.2
4	562.0	65.1	12.4	14.6
5 (Top)	445.3	61.5	18.0	10.4
Total	390.2	64.0	12.8	15.6
5-1:	267.9 (0.000)	-5.0 (0.022)	6.9 (0.000)	-5.7 (0.001)
5-4:	-116.7 (0.100)	-3.7 (0.110)	5.6 (0.000)	-4.2 (0.019)
2-1:	84.1 (0.014)	-5.0 (0.027)	-0.2 (0.891)	3.6 (0.079)

(continued)

**Table 7** -Continued

<b>Panel C: Jensen's Alpha</b>				
	TNA	Households	Financial Corporations	Insur. Companies & Pension Funds
1 (Bottom)	193.1	67.3	10.8	16.3
2	298.2	61.2	10.4	20.2
3	435.6	66.4	11.1	16.5
4	529.2	62.2	14.1	15.0
5 (Top)	495.1	62.4	17.5	10.1
Total	390.2	64.0	12.8	15.6
5-1:	302.0 (0.000)	-4.9 (0.020)	6.7 (0.000)	-6.2 (0.000)
5-4:	-34.1 (0.633)	0.2 (0.922)	3.5 (0.015)	-4.9 (0.007)
2-1:	105.2 (0.008)	-6.1 (0.008)	-0.4 (0.795)	3.9 (0.053)

**Table 8: Investor Composition by Performance: Regression Results**

This table shows the regression results of the share of depositor group on lagged performance and lagged control variables. Quintile 1 is a dummy variable that is equal to one if the fund is in the first performance quintile and zero otherwise. Quintile 2 - Quintile 5 are constructed in the same way. The omitted category is the 3rd quintile. Volatility is measured as the standard deviation over the performance evaluation period (24 months), total fee is the expense ratio plus 1/3 of total loads, size is measured by the natural logarithm of assets and age is the natural logarithm of one plus age in years. All specifications include time and investment objective fixed effects. Robust standard errors clustered at the fund level are given in parentheses. \*, \*\*, and \*\*\* indicate significance at the 10%, 5% and 1% level respectively.

	Households	Financial Corporations	Insur. Companies & Pension Funds
Quintile 1	-0.66 (4.08)	-0.54 (2.50)	2.04 (3.43)
Quintile 2	-3.93 (3.37)	-2.23 (1.51)	4.51* (2.46)
Quintile 4	2.02 (3.00)	0.72 (1.60)	-2.58 (2.21)
Quintile 5	-5.65 (3.58)	4.78** (2.13)	-3.15 (3.11)
Volatility	-2.16 (4.05)	7.41*** (2.61)	-2.11 (2.70)
Total Fee	0.49 (3.19)	-1.35 (1.75)	5.23** (2.11)
Size	-1.43 (1.18)	0.80 (0.71)	0.83 (0.93)
Age	4.08 (3.25)	-6.41*** (1.84)	3.55 (3.08)
Constant	93.86*** (34.13)	-24.45 (18.57)	-8.99 (25.39)
Time Fixed Effects	Yes	Yes	Yes
Inv. Obj. Fixed Effects	Yes	Yes	Yes
Observations	1655	1655	1655
R-squared	0.053	0.143	0.080

(continued)

Table 8 -Continued

<b>Panel B: Sharpe Ratio</b>			
	Households	Financial Corporations	Insur. Companies & Pension Funds
Quintile 1	0.16 (3.92)	-0.53 (2.44)	-0.23 (3.37)
Quintile 2	-4.30 (3.03)	-0.58 (1.45)	3.10 (2.74)
Quintile 4	-0.45 (2.68)	1.13 (1.33)	-2.48 (2.18)
Quintile 5	-3.33 (3.16)	5.70*** (1.76)	-5.38* (2.79)
Volatility	-2.87 (4.07)	9.15*** (2.64)	-3.99 (2.66)
Total Fee	0.38 (3.22)	-1.06 (1.75)	5.07** (2.14)
Size	-1.49 (1.20)	0.80 (0.69)	0.82 (0.94)
Age	4.43 (3.27)	-6.35*** (1.82)	3.23 (3.09)
Constant	98.18*** (34.70)	-35.01* (18.04)	3.25 (26.00)
Time Fixed Effects	Yes	Yes	Yes
Inv. Obj. Fixed Effects	Yes	Yes	Yes
Observations	1655	1655	1655
R-squared	0.049	0.145	0.080

(continued)

Table 8 -Continued

Panel C: Jensen's Alpha			
	Households	Financial Corporations	Insur. Companies & Pension Funds
Quintile 1	0.71 (4.09)	-1.32 (2.40)	0.66 (3.46)
Quintile 2	-5.63* (3.14)	-0.89 (1.53)	4.73* (2.75)
Quintile 4	-3.34 (2.61)	2.13* (1.28)	-0.41 (2.24)
Quintile 5	-3.31 (3.25)	4.66*** (1.78)	-4.92* (2.82)
Volatility	-3.01 (4.01)	8.65*** (2.63)	-3.20 (2.64)
Total Fee	0.26 (3.21)	-1.10 (1.75)	5.20** (2.17)
Size	-1.42 (1.19)	0.74 (0.70)	0.87 (0.93)
Age	4.54 (3.30)	-6.37*** (1.83)	3.10 (3.10)
Constant	98.23*** (33.98)	-30.97* (17.95)	-2.70 (25.34)
Time Fixed Effects	Yes	Yes	Yes
Inv. Obj. Fixed Effects	Yes	Yes	Yes
Observations	1655	1655	1655
R-squared	0.051	0.142	0.083



cfr working papers are available for download from [www.cfr-cologne.de](http://www.cfr-cologne.de).

hardcopies can be ordered from: centre for financial research (cfr),  
 albertus magnus platz, 50923 koeln, germany.

#### 2011

No.	Author(s)	Title
11-02	S.Jank	Are There Disadvantaged Clienteles in Mutual Funds?
11-01	J. Hengelbrock, E. Theissen, Ch. Westheide	Market Response to Investor Sentiment

#### 2010

No.	Author(s)	Title
10-20	G. Cici, S. Gibson, J.J. Merrick Jr.	Missing the Marks? Dispersion in Corporate Bond Valuations Across Mutual Funds
10-19	V. Agarwal, W. H. Fung, Y. C. Loon, N. Y. Naik	Risk and Return in Convertible Arbitrage: Evidence from the Convertible Bond Market
10-18	G. Cici, S. Gibson	The Performance of Corporate-Bond Mutual Funds: Evidence Based on Security-Level Holdings
10-17	D. Hess, D. Kreutzmann, O. Pucker	Projected Earnings Accuracy and the Profitability of Stock Recommendations
10-16	S. Jank, M. Wedow	Sturm und Drang in Money Market Funds: When Money Market Funds Cease to Be Narrow
10-15	G. Cici, A. Kempf, A. Puetz	Caught in the Act: How Hedge Funds Manipulate their Equity Positions
10-14	J. Grammig, S. Jank	Creative Destruction and Asset Prices
10-13	S. Jank, M. Wedow	Purchase and Redemption Decisions of Mutual Fund Investors and the Role of Fund Families
10-12	S. Artmann, P. Finter, A. Kempf, S. Koch, E. Theissen	The Cross-Section of German Stock Returns: New Data and New Evidence
10-11	M. Chesney, A. Kempf	The Value of Tradeability
10-10	S. Frey, P. Herbst	The Influence of Buy-side Analysts on Mutual Fund Trading
10-09	V. Agarwal, W. Jiang, Y. Tang, B. Yang	Uncovering Hedge Fund Skill from the Portfolio Holdings They Hide

10-08	V. Agarwal, V. Fos, W. Jiang	Inferring Reporting Biases in Hedge Fund Databases from Hedge Fund Equity Holdings
10-07	V. Agarwal, G. Bakshi, J. Huij	Do Higher-Moment Equity Risks Explain Hedge Fund Returns?
10-06	J. Grammig, F. J. Peter	Tell-Tale Tails
10-05	K. Drachter, A. Kempf	Höhe, Struktur und Determinanten der Managervergütung- Eine Analyse der Fondsbranche in Deutschland
10-04	J. Fang, A. Kempf, M. Trapp	Fund Manager Allocation
10-03	P. Finter, A. Niessen- Ruenzi, S. Ruenzi	The Impact of Investor Sentiment on the German Stock Market
10-02	D. Hunter, E. Kandel, S. Kandel, R. Wermers	Endogenous Benchmarks
10-01	S. Artmann, P. Finter, A. Kempf	Determinants of Expected Stock Returns: Large Sample Evidence from the German Market

## 2009

No.	Author(s)	Title
09-17	E. Theissen	Price Discovery in Spot and Futures Markets: A Reconsideration
09-16	M. Trapp	Trading the Bond-CDS Basis – The Role of Credit Risk and Liquidity
09-14	A. Kempf, O. Korn, M. Uhrig-Homburg	The Term Structure of Illiquidity Premia
09-13	W. Bühler, M. Trapp	Time-Varying Credit Risk and Liquidity Premia in Bond and CDS Markets
09-12	W. Bühler, M. Trapp	Explaining the Bond-CDS Basis – The Role of Credit Risk and Liquidity
09-11	S. J. Taylor, P. K. Yadav, Y. Zhang	Cross-sectional analysis of risk-neutral skewness
09-10	A. Kempf, C. Merkle, A. Niessen	Low Risk and High Return - How Emotions Shape Expectations on the Stock Market
09-09	V. Fotak, V. Raman, P. K. Yadav	Naked Short Selling: The Emperor's New Clothes?
09-08	F. Bardong, S.M. Bartram, P.K. Yadav	Informed Trading, Information Asymmetry and Pricing of Information Risk: Empirical Evidence from the NYSE
09-07	S. J. Taylor , P. K. Yadav, Y. Zhang	The information content of implied volatilities and model-free volatility expectations: Evidence from options written on individual stocks
09-06	S. Frey, P. Sandas	The Impact of Iceberg Orders in Limit Order Books
09-05	H. Beltran-Lopez, P. Giot, J. Grammig	Commonalities in the Order Book
09-04	J. Fang, S. Ruenzi	Rapid Trading bei deutschen Aktienfonds: Evidenz aus einer großen deutschen Fondsgesellschaft
09-03	A. Banegas, B. Gillen, A. Timmermann, R. Wermers	The Performance of European Equity Mutual Funds
09-02	J. Grammig, A. Schrimpf,	Long-Horizon Consumption Risk and the Cross-Section

	M. Schuppli	of Returns: New Tests and International Evidence
09-01	O. Korn, P. Koziol	The Term Structure of Currency Hedge Ratios

## 2008

No.	Author(s)	Title
08-12	U. Bonenkamp, C. Homburg, A. Kempf	Fundamental Information in Technical Trading Strategies
08-11	O. Korn	Risk Management with Default-risky Forwards
08-10	J. Grammig, F.J. Peter	International Price Discovery in the Presence of Market Microstructure Effects
08-09	C. M. Kuhnen, A. Niessen	Public Opinion and Executive Compensation
08-08	A. Pütz, S. Ruenzi	Overconfidence among Professional Investors: Evidence from Mutual Fund Managers
08-07	P. Osthoff	What matters to SRI investors?
08-06	A. Betzer, E. Theissen	Sooner Or Later: Delays in Trade Reporting by Corporate Insiders
08-05	P. Linge, E. Theissen	Determinanten der Aktionärspräsenz auf Hauptversammlungen deutscher Aktiengesellschaften
08-04	N. Hautsch, D. Hess, C. Müller	Price Adjustment to News with Uncertain Precision
08-03	D. Hess, H. Huang, A. Niessen	How Do Commodity Futures Respond to Macroeconomic News?
08-02	R. Chakrabarti, W. Megginson, P. Yadav	Corporate Governance in India
08-01	C. Andres, E. Theissen	Setting a Fox to Keep the Geese - Does the Comply-or-Explain Principle Work?

## 2007

No.	Author(s)	Title
07-16	M. Bär, A. Niessen, S. Ruenzi	The Impact of Work Group Diversity on Performance: Large Sample Evidence from the Mutual Fund Industry
07-15	A. Niessen, S. Ruenzi	Political Connectedness and Firm Performance: Evidence From Germany
07-14	O. Korn	Hedging Price Risk when Payment Dates are Uncertain
07-13	A. Kempf, P. Osthoff	SRI Funds: Nomen est Omen
07-12	J. Grammig, E. Theissen, O. Wuensche	Time and Price Impact of a Trade: A Structural Approach
07-11	V. Agarwal, J. R. Kale	On the Relative Performance of Multi-Strategy and Funds of Hedge Funds
07-10	M. Kasch-Haroutounian, E. Theissen	Competition Between Exchanges: Euronext versus Xetra
07-09	V. Agarwal, N. D. Daniel, N. Y. Naik	Do hedge funds manage their reported returns?

07-08	N. C. Brown, K. D. Wei, R. Wermers	Analyst Recommendations, Mutual Fund Herding, and Overreaction in Stock Prices
07-07	A. Betzer, E. Theissen	Insider Trading and Corporate Governance: The Case of Germany
07-06	V. Agarwal, L. Wang	Transaction Costs and Value Premium
07-05	J. Grammig, A. Schrimpf	Asset Pricing with a Reference Level of Consumption: New Evidence from the Cross-Section of Stock Returns
07-04	V. Agarwal, N.M. Boyson, N.Y. Naik	Hedge Funds for retail investors? An examination of hedged mutual funds
07-03	D. Hess, A. Niessen	The Early News Catches the Attention: On the Relative Price Impact of Similar Economic Indicators
07-02	A. Kempf, S. Ruenzi, T. Thiele	Employment Risk, Compensation Incentives and Managerial Risk Taking - Evidence from the Mutual Fund Industry -
07-01	M. Hagemeister, A. Kempf	CAPM und erwartete Renditen: Eine Untersuchung auf Basis der Erwartung von Marktteilnehmern

## 2006

No.	Author(s)	Title
06-13	S. Čeljo-Hörhager, A. Niessen	How do Self-fulfilling Prophecies affect Financial Ratings? - An experimental study
06-12	R. Wermers, Y. Wu, J. Zechner	Portfolio Performance, Discount Dynamics, and the Turnover of Closed-End Fund Managers
06-11	U. v. Lilienfeld-Toal, S. Ruenzi	Why Managers Hold Shares of Their Firm: An Empirical Analysis
06-10	A. Kempf, P. Osthoff	The Effect of Socially Responsible Investing on Portfolio Performance
06-09	R. Wermers, T. Yao, J. Zhao	The Investment Value of Mutual Fund Portfolio Disclosure
06-08	M. Hoffmann, B. Kempa	The Poole Analysis in the New Open Economy Macroeconomic Framework
06-07	K. Drachter, A. Kempf, M. Wagner	Decision Processes in German Mutual Fund Companies: Evidence from a Telephone Survey
06-06	J.P. Krahnert, F.A. Schmid, E. Theissen	Investment Performance and Market Share: A Study of the German Mutual Fund Industry
06-05	S. Ber, S. Ruenzi	On the Usability of Synthetic Measures of Mutual Fund Net- Flows
06-04	A. Kempf, D. Mayston	Liquidity Commonality Beyond Best Prices
06-03	O. Korn, C. Koziol	Bond Portfolio Optimization: A Risk-Return Approach
06-02	O. Scaillet, L. Barras, R. Wermers	False Discoveries in Mutual Fund Performance: Measuring Luck in Estimated Alphas
06-01	A. Niessen, S. Ruenzi	Sex Matters: Gender Differences in a Professional Setting

## 2005

No.	Author(s)	Title
05-16	E. Theissen	An Analysis of Private Investors' Stock Market Return Forecasts

05-15	T. Foucault, S. Moinas, E. Theissen	Does Anonymity Matter in Electronic Limit Order Markets
05-14	R. Kosowski, A. Timmermann, R. Wermers, H. White	Can Mutual Fund „Stars“ Really Pick Stocks? New Evidence from a Bootstrap Analysis
05-13	D. Avramov, R. Wermers	Investing in Mutual Funds when Returns are Predictable
05-12	K. GRIESE, A. Kempf	Liquiditätsdynamik am deutschen Aktienmarkt
05-11	S. Ber, A. Kempf, S. Ruenzi	Determinanten der Mittelzuflüsse bei deutschen Aktienfonds
05-10	M. Bär, A. Kempf, S. Ruenzi	Is a Team Different From the Sum of Its Parts? Evidence from Mutual Fund Managers
05-09	M. Hoffmann	Saving, Investment and the Net Foreign Asset Position
05-08	S. Ruenzi	Mutual Fund Growth in Standard and Specialist Market Segments
05-07	A. Kempf, S. Ruenzi	Status Quo Bias and the Number of Alternatives - An Empirical Illustration from the Mutual Fund Industry –
05-06	J. Grammig, E. Theissen	Is Best Really Better? Internalization in Xetra BEST
05-05	H. Beltran, J. Grammig, A.J. Menkveld	Understanding the Limit Order Book: Conditioning on Trade Informativeness
05-04	M. Hoffmann	Compensating Wages under different Exchange rate Regimes
05-03	M. Hoffmann	Fixed versus Flexible Exchange Rates: Evidence from Developing Countries
05-02	A. Kempf, C. Memmel	On the Estimation of the Global Minimum Variance Portfolio
05-01	S. Frey, J. Grammig	Liquidity supply and adverse selection in a pure limit order book market

## 2004

No.	Author(s)	Title
04-10	N. Hautsch, D. Hess	Bayesian Learning in Financial Markets – Testing for the Relevance of Information Precision in Price Discovery
04-09	A. Kempf, K. Kreuzberg	Portfolio Disclosure, Portfolio Selection and Mutual Fund Performance Evaluation
04-08	N.F. Carline, S.C. Linn, P.K. Yadav	Operating performance changes associated with corporate mergers and the role of corporate governance
04-07	J.J. Merrick, Jr., N.Y. Naik, P.K. Yadav	Strategic Trading Behavior and Price Distortion in a Manipulated Market: Anatomy of a Squeeze
04-06	N.Y. Naik, P.K. Yadav	Trading Costs of Public Investors with Obligatory and Voluntary Market-Making: Evidence from Market Reforms
04-05	A. Kempf, S. Ruenzi	Family Matters: Rankings Within Fund Families and Fund Inflows
04-04	V. Agarwal, N.D. Daniel, N.Y. Naik	Role of Managerial Incentives and Discretion in Hedge Fund Performance
04-03	V. Agarwal, W.H. Fung, J.C. Loon, N.Y. Naik	Liquidity Provision in the Convertible Bond Market: Analysis of Convertible Arbitrage Hedge Funds

04-02	A. Kempf, S. Ruenzi	Tournaments in Mutual Fund Families
04-01	I. Chowdhury, M. Hoffmann, A. Schabert	Inflation Dynamics and the Cost Channel of Monetary Transmission



centre for financial research  
cfr/university of cologne  
albertus-magnus-platz  
D-50923 cologne  
fon +49(0)221-470-6995  
fax +49(0)221-470-3992  
kempf@cfr-cologne.de  
www.cfr-cologne.de