Institutional Money Manager Mutual Funds

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Overview of IMMMF

- **Relation Between Clientele and Outperformance**
  - Institutional clients can better identify skilled investment advisors
  - Focus on the possible search frictions from finding investment advisors
- **Empirical Approach Using Survivor-Bias-Free Databases**
  - Form ADV and CRSP Database
- **Why Is This Interesting?**
  - Empirical evidence that institutional investors outperform
  - Provides support to Gârleanu and Pedersen (2017)
  - Possible implications for investment advisors, institutional, and retail clients

Results of IMMMF

- **Baseline Results (Table 3)**
  - One basis point higher annual performance (4-factor alpha) for every percentage point increase in the adviser's institutional clientele
- **Driven By Advisors That Managed Other Assets (Table 4)**
  - Firms with a greater fraction of assets managed in vehicles other than mutual funds drive the baseline results
- **Driven by a Subset of Funds (Table 5)**
  - Driven by sub-sample of small/mid-cap funds, and high active share funds
- **Correlation b/w Institutional Clientele and Characteristics (Table 6)**
  - (1) Past performance, (2) Lower expense ratio, (3) Variation in flows
- **Robustness Tests (Table 7-13)**
  - Flow performance,Change in institutional clientele, Sub-advisor/affiliated IA, Other business, Institutional share class, Client Decomposition, FM/13-F Ownership regression

Comment 1: Pinning Down GP2017

- **Identification Strategy**
    - The author may be able to make a causal statement about search frictions
    - Currently, the empirical results are an equilibrium outcome
- **Then the author can try to directly measure search frictions**
    - Consider Gârleanu and Pedersen 2017 (GP2017), Appendix B
- **There are other testable implications of GP2017**
    - Consider the distribution of noise and informed traders
    - Primary friction comes from search costs, and economies of scale

Comment 2: Alternative Explanation

Partial list of alternative explanations include:

- **(A) Limits of Arbitrage**
- **(B) Discount for Larger Commitment**
- **(C) Possible Omitted Variable**

Comment 2A: Limits of Arbitrage

- **Limits of Arbitrage**
  - Separation of brains and capital (Shleifer Vishny 1997)
  - Institutional investors are less likely to liquidate due to noise traders
    - Supported by Table 5, Panel B, highly active investors, but patient?
- **It would be interesting to see if institutional investors at the investment advisor affects the stability of the investment advisors they manage**
  - Using your institutional client measure, it seems that fund managers are purely seeking risk-adjusted excess returns (Table 7)
- **It would also be interesting to see if your measure also provides stability to investment advisors (and their funds), because they are not affected by noise traders**
  - You may consider using a maximum drawdown measure measure to explore this story (in terms of mechanisms)

Comment 2B: Discount for Larger Commitment

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Comment 2B: Discount for Larger Commitment

Item 5 – Fees and Compensation

U.S. Small Cap Value

Assets (millions)	Fee (BPs)
$0-25	75
Next $25	65
Additional amounts over $50	55

U.S. Small/Mid Cap Value

Assets (millions)	Fee (BPs)
$0-25	70
Next $25	60
Additional amounts over $50	50

U.S. Mid Cap Value

Assets (millions)	Fee (BPs)
$0-25	65
Next $25	55
Additional amounts over $50	45

U.S. Large Cap Value

Assets (millions)	Fee (BPs)
$0-25	60
Next $25	50
Next $50	40
Next $100	35
Additional amounts over $200	30

>> Supported by Table 6, but likely not the full story

Comment 2C: Omitted Variable, Closed Funds

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More Funds Shut Doors to New Investors

By Veronica Dagher

April 7, 2013 4:00 p.m. ET

Just as some investors are coming back into the stock market, more mutual funds are closing their doors to their money.

From The Experts

The Latest Scores Are In:

>> Institutional investors at the IA level may correlate with soft/hard closed funds, which may correlate with returns

Comment 3: Interpretation of Results

“A one basis point increase in annual outperformance for every additional percentage point increase in institutional clientele for the fund’s investment adviser.“

- **How should we interpret the economic magnitude of the results?**
  - Consider the rents extracted by consultants
  - If this is large enough, why aren’t ’noise’ traders copying institutional investors? Why does this empirically exist?
- **How should we interpret this result in terms of welfare?**
  - Retail/noise traders are mis-allocating to investment advisors
- **How should we think of search costs within institutional investors?**
  - How extendable are these results to other asset classes (PE/HF/FI)?

Comment 4: Other Considerations

- **Section 5 Has Useful Information That You May Use**
  - (5A) Approximately how many employees do you have? Include full- and part-time employees but do not include any clerical workers
  - (B1) Approximately how many of the employees reported in 5.A. perform investment advisory functions (including research)?
  - (B6) Approximately how many firms or other persons solicit advisory clients on your behalf?

- $\%InstClient = \%Public + \%Corporate + \%Charity + \%PrivateFunds$
  - Would be great to see a decomposition of $\%InstClient$
  - Is $\%InstClient$ monotonic? Quantile regression?

- **Show the distribution of institutional investors**

- **Mid-point of investment advisor investment**
  - For robustness, try both low point and high point

Conclusion

- Paper sheds light on the investment advisory firm's clients and their relation to the performance of its mutual funds!

- A take-home message
  - Copy the 'smart' money investors
  - Search frictions are an important consideration

Thank You