Financial Product Design and Catering: Evidence from the Global Mutual Fund Industry

Mancy Luo
*Tilburg University and CentER*

4th SUERF/UniCredit & Universities Foundation Workshop
January 26th, 2017
Motivation
Motivation

• The delegated money management industry is huge.
Motivation

• The delegated money management industry is huge.
  - In 2014, global AUM was $70 trillion.
Motivation

• The delegated money management industry is huge.
  - In 2014, global AUM was $70 trillion.

• What drives asset managers’ portfolio decisions?
Motivation

• The delegated money management industry is huge.
  - In 2014, global AUM was $70 trillion.

• What drives asset managers’ portfolio decisions?

• Literature: how mutual funds invest to deliver performance.
  – Investor preference is defined over portfolio performance.
Motivation

• The delegated money management industry is huge.
  - In 2014, global AUM was $70 trillion.

• What drives asset managers’ portfolio decisions?

• Literature: how mutual funds invest to deliver performance.
  – Investor preference is defined over portfolio performance.
  
  “The key first principle of modern finance, going back to Markowitz, is that preferences attach to money – to the payoffs of portfolios – not to the securities that make up portfolios.”

  John Cochrane, in his commentary blog (October 9, 2016)
Motivation

• The delegated money management industry is huge.
  - In 2014, global AUM was $70 trillion.

• What drives asset managers’ portfolio decisions?

• Literature: how mutual funds invest to deliver performance.
  – Investor preference is defined over portfolio performance.

• What if investors also have non-performance-related preference for portfolio composition?
Motivation

• The delegated money management industry is huge.
  - In 2014, global AUM was $70 trillion.

• What drives asset managers’ portfolio decisions?

• Literature: how mutual funds invest to deliver performance.
  – Investor preference is defined over portfolio performance.

• What if investors also have non-performance-related preference for portfolio composition?

• How does this affect asset managers’ portfolio decisions?
This Paper

1. Uses a sample of active international equity mutual funds.
2. Examines the impact of investors’ preference for local stocks on their portfolio choices.
This Paper

1. Uses a sample of active *international* equity mutual funds.
2. Examines the impact of investors’ preference for *local stocks* on their portfolio choices.
   - distribution channels, i.e., *client countries* where funds are sold.
This Paper

1. Uses a sample of active international equity mutual funds.
2. Examines the impact of investors’ preference for local stocks on their portfolio choices.
   - distribution channels, i.e., client countries where funds are sold.
   - sharp identification, i.e., three-dimensional fixed effects.
This Paper

1. Uses a sample of active international equity mutual funds.
2. Examines the impact of investors’ preference for local stocks on their portfolio choices.
   - distribution channels, i.e., client countries where funds are sold.
   - sharp identification, i.e., three-dimensional fixed effects.

Main results:
This Paper

1. Uses a sample of active international equity mutual funds.
2. Examines the impact of investors’ preference for local stocks on their portfolio choices.
   - distribution channels, i.e., client countries where funds are sold.
   - sharp identification, i.e., three-dimensional fixed effects.

Main results:

1. Client-country overweighting: funds overweight stocks from their client countries.
2. Catering-driven investment: … not driven by funds’ familiarity or by an information advantage
3. Higher flows and underperforming portfolios.
This Paper

1. Uses a sample of active international equity mutual funds.
2. Examines the impact of investors’ preference for local stocks on their portfolio choices.
   - distribution channels, i.e., client countries where funds are sold.
   - sharp identification, i.e., three-dimensional fixed effects.

Main results:

1. Client-country overweighting: funds overweight stocks from their client countries.
2. Catering-driven investment: … not driven by funds’ familiarity or by an information advantage
3. Higher flows and underperforming portfolios.
This Paper

1. Uses a sample of active international equity mutual funds.
2. Examines the impact of investors’ preference for local stocks on their portfolio choices.
   - distribution channels, i.e., client countries where funds are sold.
   - sharp identification, i.e., three-dimensional fixed effects.

Main results:
1. Client-country overweighting: funds overweight stocks from their client countries.
2. Catering-driven investment: … not driven by funds’ familiarity or by an information advantage
3. Higher flows and underperforming portfolios.
Empirical Challenges (I/IV)
Empirical Challenges (I/IV)

Fund A
Empirical Challenges (I/IV)

Fund A
Empirical Challenges (I/IV)

Fund A

Investors
Empirical Challenges (I/IV)

Fund A

Investors
Empirical Challenges (I/IV)

Fund A

Investors

Sec1
Empirical Challenges (I/IV)

Fund A

Investors

Sec1

Sec2
Empirical Challenges (I/IV)

Fund A

Investors

Sec1
Sec2
Sec3
Empirical Challenges (I/IV)

Fund A

Investors

Sec1
Sec2
Sec3
Sec4
Empirical Challenges (I/IV)

- Preference candidate.
Empirical Challenges (I/IV)

- Preference candidate.
  - Solution: Preference for local stocks.
Empirical Challenges (II/IV)

- Preference candidate.
- Preference measure.
Empirical Challenges (II/IV)

- Preference candidate.
- Preference measure.
  - Solution: Link local preference with funds’ distribution channels – not rely on proxies
Empirical Challenges (III/IV)

- Preference candidate.
- Preference measure.
- Discretion for investment.
Empirical Challenges (III/IV)

- Preference candidate.
- Preference measure.
- Discretion for investment.

Fund A: Sec1, Sec2, Sec3, Sec4

Investors: Local Stocks
- Sec1, Sec2, Sec4
- Sec3

Sold
Empirical Challenges (III/IV)

- Preference candidate.
- Preference measure.
- Discretion for investment.

Fund A: Sec1, Sec2, Sec3, Sec4, Sec5 → Sold → Investors: Local Stocks: Sec1, Sec2, Sec3, Sec4, Sec5
Empirical Challenges (III/IV)

- Preference candidate.
- Preference measure.
- Discretion for investment.
Empirical Challenges (III/IV)

- Preference candidate.
- Preference measure.
- Discretion for investment.
  - Solution: Go abroad.
Empirical Challenges (III/IV)

- Preference candidate.
- Preference measure.
- Discretion for investment.
  - Solution: Go abroad.
Empirical Challenges (III/IV)

- Preference candidate.
- Preference measure.
- Discretion for investment.
  - Solution: Go abroad.
An Example of “Going Abroad”
An Example of “Going Abroad”

Henderson Global - World Select Fund
An Example of “Going Abroad”

Henderson Global - World Select Fund
- Investment objective “Global Equity”
An Example of “Going Abroad”

Henderson Global - World Select Fund
- Investment objective “Global Equity”

Investment Country
An Example of “Going Abroad”

Henderson Global - World Select Fund
- Investment objective “Global Equity”

Investment Country
An Example of “Going Abroad”

Henderson Global - World Select Fund
- Investment objective “Global Equity”
An Example of “Going Abroad”

Henderson Global - World Select Fund
- Investment objective “Global Equity”
An Example of “Going Abroad”

Henderson Global - World Select Fund
- Investment objective “Global Equity”
An Example of “Going Abroad”

Henderson Global - World Select Fund
- Investment objective “Global Equity”
- Managed by Henderson Global Investors Ltd.

Investment Country

[Map images of the United Kingdom, United States, France, and Netherlands]
An Example of “Going Abroad”

Henderson Global - World Select Fund
- Investment objective “Global Equity”
- Managed by Henderson Global Investors Ltd.
An Example of “Going Abroad”

Henderson Global - World Select Fund
- Investment objective “Global Equity”
- Managed by Henderson Global Investors Ltd.
An Example of “Going Abroad”

Henderson Global - World Select Fund
- Investment objective “Global Equity”
- Managed by Henderson Global Investors Ltd.
- Available for sale in the U.S.
An Example of “Going Abroad”

Henderson Global - World Select Fund
- Investment objective “Global Equity”
- Managed by Henderson Global Investors Ltd.
- Available for sale in the U.S.

<table>
<thead>
<tr>
<th>Investment Country</th>
<th>Home Country</th>
<th>Client Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>United States</td>
<td>United States</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>United Kingdom</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>France</td>
<td>United Kingdom</td>
<td>United States</td>
</tr>
<tr>
<td>Netherlands</td>
<td>United Kingdom</td>
<td>United States</td>
</tr>
</tbody>
</table>
Empirical Challenges (III/IV)

- Preference candidate.
- Preference measure.
- Discretion for investment.
  - Solution: Go abroad.
Empirical Challenges (IV/IV)

- Preference candidate.
- Preference measure.
- Discretion for investment.
- Unobserved differences across investment countries and asset managers.
Empirical Challenges (IV/IV)

- Preference candidate.
- Preference measure.
- Discretion for investment.
- Unobserved differences across investment countries and asset managers.
  - Solution: Data allows for investment country × date,
Empirical Challenges (IV/IV)

- Preference candidate.
- Preference measure.
- Discretion for investment.
- Unobserved differences across investment countries and asset managers.
  - Solution: Data allows for investment country $\times$ date, home country $\times$ investment country $\times$ date,
Empirical Challenges (IV/IV)

- Preference candidate.
- Preference measure.
- Discretion for investment.
- Unobserved differences across investment countries and asset managers.
  - Solution: Data allows for investment country × date, home country × investment country × date, management firm × investment country × date fixed effects.
Do Funds Overweight Client Country Stocks?
Do Funds Overweight Client Country Stocks?
Raw Data (I/II)

Excess Weight% in Client Country of Funds Located in Top 20 Home Countries

Excess Weight% in Client Country Stock

- Sample
- United States
- United Kingdom
- France
- Germany
- Sweden
- Netherlands
- Canada
- Switzerland
- Italy
- Hong Kong
- Australia
- Denmark
- Norway
- Spain
- Singapore
- Belgium
- Ireland
- Austria
- South Africa
- Finland

Excess Weight% in Client Country
Do Funds Overweight Client Country Stocks?
Raw Data (II/II)

Excess Weight% in Client Country of Funds Sold in Top 20 Client Countries

- Sample
- United States
- United Kingdom
- France
- Germany
- Switzerland
- Austria
- Netherlands
- Sweden
- Italy
- Luxembourg
- Spain
- Belgium
- Finland
- Canada
- Ireland
- Norway
- Denmark
- Taiwan
- Australia
- Hong Kong

Excess Weight% in Client Country
Do Funds Overweight Client Country Stocks?
Main Finding (I/II)

\[ \text{Excess Weight}_{fct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} + \gamma'x_{ft} + \varepsilon_{ft} \]

\[ \text{Excess Weight}_{fct} = \frac{w_{fct} - \overline{W}_{ct}}{\overline{W}_{ct}} \]
Do Funds Overweight Client Country Stocks?
Main Finding (I/II)

\[ \text{Excess Weight}_{fct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} + \gamma' x_{ft} + \varepsilon_{ft} \]

\[ \text{Excess Weight}_{fct} = \frac{w_{fct} - \bar{w}_{ct}}{\bar{w}_{ct}} \]

*Client Country* is a client country indicator.
Do Funds Overweight Client Country Stocks?

Main Finding (I/II)

\[ Excess\ Weight_{fct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} + \gamma' x_{ft} + \epsilon_{ft} \]

\[ Excess\ Weight_{fct} = \frac{w_{fct} - \bar{w}_{ct}}{\bar{w}_{ct}} \]

*Client Country* is a client country indicator.
Do Funds Overweight Client Country Stocks?

Main Finding (I/II)

\[ Excess \ Weight_{fct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} + \gamma'x_{ft} + \varepsilon_{ft} \]

\[ Excess \ Weight_{fct} = \frac{w_{fct} - \bar{w}_{ct}}{\bar{w}_{ct}} \]

*Client Country* is a client country indicator.

*Home Country* is a home country indicator to control for fund location.
Do Funds Overweight Client Country Stocks?
Main Finding (I/II)

\[
Excess Weight_{fc} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fc} + \gamma' x_{ft} + \epsilon_{ft}
\]

\[
Excess Weight_{fc} = \frac{w_{fc} - \bar{w}_c}{\bar{w}_c}
\]

\text{Client Country} is a client country indicator.
\text{Home Country} is a home country indicator to control for fund location.
\text{x}_{ft} includes controls and fixed effects:
Do Funds Overweight Client Country Stocks?

Main Finding (I/II)

\[
Excess \ Weight_{fct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} + \gamma' x_{ft} + \epsilon_{ft}
\]

\[
Excess \ Weight_{fct} = \frac{w_{fct} - \overline{w}_{ct}}{\overline{w}_{ct}}
\]

*Client Country* is a client country indicator.

*Home Country* is a home country indicator to control for fund location.

\(x_{ft}\) includes controls and fixed effects:
- investment country \(\times\) date
Do Funds Overweight Client Country Stocks?
Main Finding (I/II)

\[
Excess \ Weight_{fct} = \alpha + \beta_1 Client \ Country_{fc} + \beta_2 Home \ Country_{fct} + \gamma' x_{ft} + \varepsilon_{ft}
\]

\[
Excess \ Weight_{fct} = \frac{w_{fct} - \bar{w}_{ct}}{\bar{w}_{ct}}
\]

*Client Country* is a client country indicator.

*Home Country* is a home country indicator to control for fund location.

\(x_{ft}\) includes controls and fixed effects:
- investment country × date
- home country × investment country × date
Do Funds Overweight Client Country Stocks?
Main Finding (I/II)

\[ Excess \, Weight_{fct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} + \gamma'x_{ft} + \varepsilon_{ft} \]

\[ Excess \, Weight_{fct} = \frac{w_{fct} - \bar{W}_{ct}}{\bar{W}_{ct}} \]

Client Country is a client country indicator.
Home Country is a home country indicator to control for fund location.

\( x_{ft} \) includes controls and fixed effects:
- investment country × date
- home country × investment country × date
- management firm × investment country × date
**Do Funds Overweight Client Country Stocks?**

**Main Finding (II/II)**

*Excess Weight*$_{fct} = \alpha + \beta_1Client Country$_{fc} + \beta_2Home Country$_{fct} + \gamma'x_{ft} + \varepsilon_{ft}  

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Client Country</strong></td>
<td>1.1965***</td>
<td>1.1459***</td>
<td>1.1557***</td>
<td>0.5447***</td>
</tr>
<tr>
<td></td>
<td>(12.24)</td>
<td>(12.01)</td>
<td>(11.83)</td>
<td>(6.26)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Control variables</th>
<th>N</th>
<th>Y</th>
<th>Y</th>
<th>Y</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment country × date f.e.</td>
<td>N</td>
<td>N</td>
<td>Y</td>
<td>N</td>
</tr>
<tr>
<td>Home ct. × investment ct. × date f.e.</td>
<td>N</td>
<td>N</td>
<td>N</td>
<td>Y</td>
</tr>
<tr>
<td>R$^2$</td>
<td>0.051</td>
<td>0.054</td>
<td>0.063</td>
<td>0.167</td>
</tr>
<tr>
<td>N</td>
<td>2,396,897</td>
<td>2,396,897</td>
<td>2,396,897</td>
<td>2,396,897</td>
</tr>
</tbody>
</table>
What Drives Client-Country Overweighting?
What Drives Client-Country Overweighting?

A. Catering.
What Drives Client-Country Overweighting?

A. Catering.

B. Funds’ Familiarity.
What Drives Client-Country Overweighting?

A. Catering.

B. Funds’ Familiarity.

C. Information Advantage.
What Drives Client-Country Overweighting?

A. Catering.

B. Funds’ Familiarity.

C. Information Advantage.
What Drives Client-Country Overweighting?
A. Do Funds Cater to Investors’ Local Preference? (I/II)
What Drives Client-Country Overweighting?
A. Do Funds Cater to Investors’ Local Preference? (I/II)

\[
Excess\ Weight_{fct} = \alpha + \beta_1 \text{Client Country}_{fct} + \beta_2 \text{Home Country}_{fct}
\]
What Drives Client-Country Overweighting? 
A. Do Funds Cater to Investors’ Local Preference? (I/II)

\[
\text{Excess Weight}_{fct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} + \beta_3 \text{Investor Home Bias}_{ct}
\]
What Drives Client-Country Overweighting?
A. Do Funds Cater to Investors’ Local Preference? (I/II)

\[ \text{Excess Weight}_{fct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} \]
\[ + \beta_3 \text{Investor Home Bias}_{ct} + \delta \text{Investor Home Bias}_{ct} \times \text{Client Country}_{fc} + \gamma' x_{fct} + \epsilon_{fct} \]
What Drives Client-Country Overweighting?  
A. Do Funds Cater to Investors’ Local Preference? (I/II)

\[
\text{Excess Weight}_{fct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} \\
+ \beta_3 \text{Investor Home Bias}_{ct} + \delta \text{Investor Home Bias}_{ct} \times \text{Client Country}_{fc} + \gamma' x_{fct} + \epsilon_{fct}
\]

<table>
<thead>
<tr>
<th></th>
<th>Client Country Funds’ Home Bias</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
</tr>
<tr>
<td></td>
<td>(2)</td>
</tr>
<tr>
<td><strong>Investor Home Bias \times Client Country</strong></td>
<td>1.4223***</td>
</tr>
<tr>
<td></td>
<td>(3.76)</td>
</tr>
<tr>
<td></td>
<td>(2.88)</td>
</tr>
</tbody>
</table>

[Control variables omitted from the table]

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Home ct. \times investment ct. \times date f.e.</strong></td>
<td>Y</td>
<td>Y</td>
</tr>
<tr>
<td><strong>R^2</strong></td>
<td>0.178</td>
<td>0.178</td>
</tr>
<tr>
<td><strong>N</strong></td>
<td>2,055,542</td>
<td>2,055,542</td>
</tr>
</tbody>
</table>
What Drives Client-Country Overweighting?

A. Do Funds Cater to Investors’ Local Preference? (I/II)

\[
\text{Excess Weight}_{fc} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fc} + \\
\beta_3 \text{Investor Home Bias}_{ct} + \delta \text{Investor Home Bias}_{ct} \times \text{Client Country}_{fc} + \gamma' x_{fc} + \epsilon_{fc}
\]

<table>
<thead>
<tr>
<th></th>
<th>Client Country Funds’ Home Bias</th>
<th>High National Pride</th>
<th>High Identity Importance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td>Invsetor Home Bias × Client Country</td>
<td>1.4223***</td>
<td>0.7722***</td>
<td>0.5293**</td>
</tr>
<tr>
<td></td>
<td>(3.76)</td>
<td>(2.88)</td>
<td>(2.53)</td>
</tr>
</tbody>
</table>

[Control variables omitted from the table]

<table>
<thead>
<tr>
<th>Home ct. × investment ct. × date f.e.</th>
<th>Y</th>
<th>Y</th>
<th>Y</th>
<th>Y</th>
</tr>
</thead>
<tbody>
<tr>
<td>R²</td>
<td>0.178</td>
<td>0.178</td>
<td>0.184</td>
<td>0.161</td>
</tr>
<tr>
<td>N</td>
<td>2,055,542</td>
<td>2,055,542</td>
<td>1,886,045</td>
<td>1,991,533</td>
</tr>
</tbody>
</table>
What Drives Client-Country Overweighting?
A. Do Funds Cater to Investors’ Local Preference? (II/II)
What Drives Client-Country Overweighting?
A. Do Funds Cater to Investors’ Local Preference? (II/II)

\[ \text{Excess Weight}_{fsct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} \]
What Drives Client-Country Overweighting?
A. Do Funds Cater to Investors’ Local Preference? (II/II)

\[Excess\ Weight_{fsct} = \alpha + \beta_1 Client\ Country_{fc} + \beta_2 Home\ Country_{fct} + \beta_3 High\ Visibility_{sct}\]
What Drives Client-Country Overweighting?
A. Do Funds Cater to Investors’ Local Preference? (II/II)

\[ Excess \ Weight_{fsct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} \]
\[ + \beta_3 \text{High Visibility}_{sct} + \delta \text{High Visibility}_{sct} \times \text{Client Country}_{fc} + \gamma' x_{fsct} + \epsilon_{fsct} \]
What Drives Client-Country Overweighting?
A. Do Funds Cater to Investors’ Local Preference? (II/II)

\[ \text{Excess Weight}_{fsct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} \]
\[ + \beta_3 \text{High Visibility}_{sct} + \delta \text{High Visibility}_{sct} \times \text{Client Country}_{fc} + \gamma'\mathbf{x}_{fsct} + \epsilon_{fsct} \]

<table>
<thead>
<tr>
<th></th>
<th>Analyst cov.</th>
<th>ROE</th>
<th>Sales</th>
<th>Media cov.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>High Visibility × Client Country</strong></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
</tr>
<tr>
<td></td>
<td>2.3134***</td>
<td>1.1787**</td>
<td>0.7144***</td>
<td>0.9124*</td>
</tr>
<tr>
<td></td>
<td>(3.71)</td>
<td>(2.37)</td>
<td>(4.46)</td>
<td>(1.92)</td>
</tr>
</tbody>
</table>

[Control variables omitted from the table]

<table>
<thead>
<tr>
<th>Home ct. × investment ct. × date f.e.</th>
<th>Y</th>
<th>Y</th>
<th>Y</th>
<th>Y</th>
</tr>
</thead>
<tbody>
<tr>
<td>R²</td>
<td>0.180</td>
<td>0.174</td>
<td>0.158</td>
<td>0.193</td>
</tr>
<tr>
<td>N</td>
<td>5,660,797</td>
<td>5,660,797</td>
<td>5,660,797</td>
<td>5,660,797</td>
</tr>
</tbody>
</table>
What Drives Client-Country Overweighting?
B. Do Funds Have Familiarity Towards Client Countries? (I/II)
What Drives Client-Country Overweighting?
B. Do Funds Have Familiarity Towards Client Countries? (I/II)

Henderson Fund A
What Drives Client-Country Overweighting?
B. Do Funds Have Familiarity Towards Client Countries? (I/II)

Henderson Fund A
What Drives Client-Country Overweighting?

B. Do Funds Have Familiarity Towards Client Countries? (I/II)

Henderson Fund A
What Drives Client-Country Overweighting?
B. Do Funds Have Familiarity Towards Client Countries? (I/II)

Henderson Fund A

Overweighting U.S. Stocks

Sold

Managed
What Drives Client-Country Overweighting?
B. Do Funds Have Familiarity Towards Client Countries? (I/II)

Henderson Fund A

Overweighting U.S. Stocks

- Driven by familiarity at the home country level?
What Drives Client-Country Overweighting?
B. Do Funds Have Familiarity Towards Client Countries? (I/II)

Henderson Fund A

- Overweighting U.S. Stocks

• Driven by familiarity at the home country level? No
What Drives Client-Country Overweighting?
B. Do Funds Have Familiarity Towards Client Countries? (I/II)

Henderson Fund A

- Driven by familiarity at the home country level? No
  - home country × investment country × date fixed effects
What Drives Client-Country Overweighting?
B. Do Funds Have Familiarity Towards Client Countries? (I/II)

- Driven by familiarity at the home country level? **No**
  - home country $\times$ investment country $\times$ date fixed effects
• Driven by familiarity at the home country level? **No**
  - home country × investment country × date fixed effects
What Drives Client-Country Overweighting?

B. Do Funds Have Familiarity Towards Client Countries? (I/II)

- Driven by familiarity at the home country level? No
  - home country × investment country × date fixed effects
What Drives Client-Country Overweighting?

B. Do Funds Have Familiarity Towards Client Countries? (I/II)

- Driven by familiarity at the home country level? No
  - home country × investment country × date fixed effects
- Driven by familiarity at the asset manager level? No
  - management firm × investment country × date fixed effects
What Drives Client-Country Overweighting?
B. Do Funds Have Familiarity Towards Client Countries? (I/II)

- Driven by familiarity at the home country level? No
  - home country × investment country × date fixed effects
- Driven by familiarity at the asset manager level? No
  - management firm × investment country × date fixed effects
What Drives Client-Country Overweighting?
B. Do Funds Have Familiarity Towards Client Countries? (II/II)
What Drives Client-Country Overweighting?

B. Do Funds Have Familiarity Towards Client Countries? (II/II)

\[ \text{Excess Weight}_{fct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} \]
What Drives Client-Country Overweighting?

B. Do Funds Have Familiarity Towards Client Countries? (II/II)

\[
\text{Excess Weight}_{fct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} \\
+ \beta_3 \text{Managerial Rotation}_{ft}
\]
What Drives Client-Country Overweighting?

B. Do Funds Have Familiarity Towards Client Countries? (II/II)

\[ \text{Excess Weight}_{fct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} \]
\[ + \beta_3 \text{Managerial Rotation}_{ft} + \delta \text{Managerial Rotation}_{ft} \times \text{Client Country}_{fc} + \gamma' x_{fct} + \epsilon_{fct} \]
**What Drives Client-Country Overweighting?**

**B. Do Funds Have Familiarity Towards Client Countries? (II/II)**

\[
\text{Excess Weight}_{fct} = \alpha + \beta_1 \text{Client Country}_{fc} + \beta_2 \text{Home Country}_{fct} + \beta_3 \text{Managerial Rotation}_{ft} + \delta \text{Managerial Rotation}_{ft} \times \text{Client Country}_{fc} + \gamma' x_{fct} + \varepsilon_{fct}
\]

<table>
<thead>
<tr>
<th></th>
<th>Entire Sample</th>
<th>Single-Managed</th>
<th>Team-Managed</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td><strong>Managerial Rotation \times Client Country</strong></td>
<td>-0.0512</td>
<td>-0.0311</td>
<td>-0.0337</td>
</tr>
<tr>
<td></td>
<td>(-0.65)</td>
<td>(-0.22)</td>
<td>(-0.39)</td>
</tr>
<tr>
<td>[Control variables omitted from the table]</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Home ct. \times investment ct. \times date f.e.</td>
<td>Y</td>
<td>Y</td>
<td>Y</td>
</tr>
<tr>
<td>R²</td>
<td>0.172</td>
<td>0.201</td>
<td>0.167</td>
</tr>
<tr>
<td>N</td>
<td>1,888,277</td>
<td>1,111,823</td>
<td>776,454</td>
</tr>
</tbody>
</table>
What Drives Client-Country Overweighting?
C. Do Funds Outperform in Client Countries?
What Drives Client-Country Overweighting?
C. Do Funds Outperform in Client Countries?

Henderson Fund A

Sold

Overweighting U.S. Stocks
What Drives Client-Country Overweighting?
C. Do Funds Outperform in Client Countries?

Henderson Fund A

Overweighting U.S. Stocks

Sold

Client Country (U.S.) Holdings
What Drives Client-Country Overweighting?
C. Do Funds Outperform in Client Countries?

Henderson Fund A

Overweighting U.S. Stocks

Client Country (U.S.) Holdings

Non Client-Country Holdings
What Drives Client-Country Overweighting?
C. Do Funds Outperform in Client Countries?

Henderson Fund A

- Overweighting U.S. Stocks
- Sold

Client Country (U.S.) Holdings

Non Client-Country Holdings
## What Drives Client-Country Overweighting?

### C. Do Funds Outperform in Client Countries?

<table>
<thead>
<tr>
<th></th>
<th>Raw Returns</th>
<th>Industry-adj. returns</th>
<th>Market-adj. returns</th>
<th>DGTW-adj. returns</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Client Country</strong></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
</tr>
<tr>
<td></td>
<td>0.0428</td>
<td>0.0089</td>
<td>0.0094</td>
<td>0.0135</td>
</tr>
<tr>
<td></td>
<td>(1.27)</td>
<td>(0.66)</td>
<td>(0.65)</td>
<td>(1.09)</td>
</tr>
<tr>
<td><strong>Non Client Country</strong></td>
<td>0.0511</td>
<td>0.0142</td>
<td>0.0153</td>
<td>0.0194</td>
</tr>
<tr>
<td></td>
<td>(1.52)</td>
<td>(1.05)</td>
<td>(1.06)</td>
<td>(1.57)</td>
</tr>
<tr>
<td><strong>Diff (Client Country – Non Client Contry)</strong></td>
<td>-0.0083</td>
<td>-0.0053</td>
<td>-0.0059</td>
<td>-0.0059</td>
</tr>
<tr>
<td><strong>T-stat (Client Country – Non Client Contry)</strong></td>
<td>(0.17)</td>
<td>(0.28)</td>
<td>(0.29)</td>
<td>(0.34)</td>
</tr>
</tbody>
</table>
Results so far

• Client-country overweighting: funds overweight stocks from their client countries

• Catering-driven investment: … not driven by funds’ familiarity or by an information advantage
Potential Consequences of Client-Country Overweighting

• Benefits for Funds: flows.

• Costs to Investors: fund performance.
Consequences (I/II): Higher Flows?

\[ \text{Flow}_{ft} = \alpha + \beta \text{Client Country Overweight}_{ft-1} + \gamma' x_{ft} + \varepsilon_{ft} \]

<table>
<thead>
<tr>
<th>Investment Flows</th>
<th>(1)</th>
<th>(2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Client Country Overweight</td>
<td>0.0192***</td>
<td>0.0180***</td>
</tr>
<tr>
<td></td>
<td>(3.05)</td>
<td>(2.77)</td>
</tr>
</tbody>
</table>

[Control variables omitted from the table]

<table>
<thead>
<tr>
<th></th>
<th>Y</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Style and date f.e.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Style × date f.e.</td>
<td>N</td>
<td>Y</td>
</tr>
<tr>
<td>( R^2 )</td>
<td>0.061</td>
<td>0.098</td>
</tr>
<tr>
<td>( N )</td>
<td>59,795</td>
<td>59,795</td>
</tr>
</tbody>
</table>
Consequences (II/II): Worse Performance?

\[ R_{ft} = \alpha + \beta \text{Client Country Overweight}_{ft} + \gamma' x_{ft} + \epsilon_{ft} \]

<table>
<thead>
<tr>
<th></th>
<th>Investment Flows</th>
<th>DGTW-adj. Returns</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td>Client Country Overweight</td>
<td>0.0192***</td>
<td>0.0180***</td>
</tr>
<tr>
<td></td>
<td>(3.05)</td>
<td>(2.77)</td>
</tr>
</tbody>
</table>

[Control variables omitted from the table]

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Style and date f.e.</td>
<td>Y</td>
<td>N</td>
<td>Y</td>
<td>N</td>
</tr>
<tr>
<td>Style × date f.e.</td>
<td>N</td>
<td>Y</td>
<td>N</td>
<td>Y</td>
</tr>
<tr>
<td>R²</td>
<td>0.061</td>
<td>0.098</td>
<td>0.176</td>
<td>0.427</td>
</tr>
<tr>
<td>N</td>
<td>59,795</td>
<td>59,795</td>
<td>93,882</td>
<td>93,882</td>
</tr>
</tbody>
</table>
Conclusion

• Novel empirical finding: client-country overweighting.

• Suggests that investors do care about other fund attributes, e.g. fund portfolio composition, and mutual funds respond.

• More broadly, it has implications for understanding how financial institutions design products to cater to investors’ preferences.