

2nd ONE-DAY CONFERENCE ON PROFESSIONAL ASSET MANAGEMENT

**Rotterdam School of Management
Erasmus University**

14 March, 2008

**Venue: Erasmus University Rotterdam, Burg. Oudlaan 50,
3062 PA Rotterdam, The Netherlands
M-building, room Tokyo (M1-17)**

Organizers: Joop Huij and Marno Verbeek

www.erim.nl/mutualfunds

www.erim.nl/hedgefunds

Local arrangements: Carina Schlosser, email: cschlosser@rsm.nl

In cooperation with CFA Netherlands, the Finance Group of RSM Erasmus University organizes a one-day academic conference on professional asset management. The main objective of the conference is to present and discuss recent advances in academic research on mutual funds, hedge funds, pension funds, and other forms of delegated portfolio management. The conference will host a limited number of paper presentations with designated discussants and ample time for discussion and interaction.

Final program

09.00-09.30 Registration

09.30-09.35 Welcome address by Marno Verbeek

09.35-11.05 Session 1 Chair: Marno Verbeek

“Reputation and Mutual Fund Choice”

Laura Starks (McCombs School of Business)

Discussant: Marno Verbeek (RSM Erasmus University)

“The Effects of Organizational Structure on Asset Management”

Massimo Massa (INSEAD) and **Lei Zhang** (INSEAD)

Discussant: **Nicole Boyson** (Northeastern University)

11.05-11.25 Official signing ceremony

Rotterdam School of Management, Erasmus University, becomes CFA program partner

Dennis McLeavey (Head of Education, EMEA Region, CFA Institute)

Eric Waarts (Dean BSc & MSc Programmes, RSM Erasmus University)

11.25-11.45 Tea/Coffee

11.45-13.15 Session 2 Chair: **Gerard Moerman** (AEGON Asset Management)

“Is There Hedge Fund Contagion?”

Nicole Boyson (Northeastern University), **Christof Stahel** (George Mason University), and **Rene Stulz** (Ohio State University)

Discussant: **Pieter-Jelle van der Sluis** (GTAA Fund, ABP Investments)

“Is a Team Different From the Sum of Its Parts? Evidence from Mutual Fund Managers”

Michaela Bär (University of Cologne), **Alexander Kempf** (University of Cologne), and **Stefan Ruenzi** (University of Cologne).

Discussant: **Ronald van Dijk** (ING Investment Management)

“Missing the marks: dispersion in corporate bond valuations across mutual funds”

Gjergji Cici (Mason School of Business), **Scott Gibson** (Mason School of Business), and **John Merrick** (Mason School of Business)

Discussant: **Patrick Herbst** (Goethe University Frankfurt)

13.15-14.30 Lunch

14.30-16.00 Session 3 Chair: Gerben de Zwart (ING Investment Management)

“Style Investing and the ICAPM”

Michael Stutzer (University of Colorado)

Discussant: Hao Jiang (RSM Erasmus University)

“The Impact of Work Group Diversity on Performance: Large Sample Evidence from the Mutual Fund Industry”

Michaela Bär (University of Cologne), Alexandra Niessen (University of Cologne), and Stefan Ruenzi (University of Cologne)

Discussant: David Blitz (Robeco Asset Management)

“Spillover Effects of Marketing in Mutual Fund Families”

Joop Huij (RSM Erasmus University) and Marno Verbeek (RSM Erasmus University)

Discussant: Russ Wermers (University of Maryland)

16.00-16.30 Tea/Coffee

16.30-17.15 Session 4 Chair: TBA

“False Discoveries in Mutual Fund Performance: Measuring Luck in Estimated Alphas”

Russ Wermers (University of Maryland), Laurent Barras (Imperial College) and Olivier Scaillet (University of Geneva)

Discussant: Jenke ter Horst (Tilburg University)

This conference is made possible by financial support from Goldman Sachs, the Erasmus Research Institute of Management (ERIM) and the Vereniging Trustfonds Erasmus Universiteit Rotterdam.

Registration

To register for this conference, please send an e-mail message to Carina Schlosser, cschlosser@rsm.nl, with your name and affiliation (as you wish to appear it on the conference badge). The registration fee is € 150 and includes lunch, coffee/tea and copies of the papers. For CFA charter holders and VBA members a reduced fee of € 125 applies. Registration of participants from academic institutions is free. The deadline for registration is **Friday 7 March 2008**.

The appropriate registration fee should be transferred to RSM Erasmus University, account number ABN/AMRO 42.90.14.155 (IBAN: NL67ABNA0429014155), mentioning "PAM conference 4070-743". Please contact Carina Schlosser, cschlosser@rsm.nl, if you wish to receive an invoice.

How to visit RSM Erasmus University

By Air

Arrival at Schiphol Airport Amsterdam: Direct train connection to Rotterdam Centre "Centraal Station" from the airport railway station, then take a taxi to the Erasmus University campus Woudestein (15 minutes).

Arrival at Rotterdam Airport (European flights only): Taxi to Erasmus University Rotterdam, campus Woudestein.

By Car

Coming from the south (A16): First follow direction "Ring Rotterdam, Den Haag". Near Ridderkerk, take directions "Feijenoord / Centrum / Kralingen / Capelle". When crossing the Van Brieneoordbrug, take exit "Rotterdam Centrum / Capelle" and you will immediately arrive on a roundabout. On the roundabout take "Rotterdam Centrum". Pass the Shell petrol station on your right side and take the first turn to the right after the Shell station. You have arrived at Burgemeester Oudlaan. Entrance of the Erasmus University main gate is 100 meters further on your right.

Coming from Utrecht and Den Haag: Follow directions "Ring Rotterdam / Dordrecht", and then "Kralingen / Feijenoord / IJsselmonde" and take exit "Capelle / Centrum". At the traffic lights follow "Rotterdam Centrum". Pass the Shell petrol station on your right side and take the first turn to the right after the Shell station. You have arrived at Burgemeester Oudlaan. Entrance of the Erasmus main gate is 100 meters further on your right.

Parking is available on campus (parking fees will be charged).

By Public Transport

From Rotterdam Central Station “Centraal Station”: Take the underground metro direction “Spijkenisse”, change at “Beurs/Churchillplein”. Take direction “Ommoord / Nesselande / Capelle”, exit at “Kralingse Zoom”. When exiting the station, facing the main road, the Erasmus University is directly across the road.

You can also take tram number 7 or 21 to "Burgemeester Oudlaan", which leaves at the front of the central station approximately every 10 minutes. The trip will take around 20 minutes and you should exit at the stop 'Erasmus Universiteit' in front of the main entrance.

ABSTRACTS

“Reputation and Mutual Fund Choice”

Laura Starks (McCombs School of Business) and Michael Yates ()

We analyze individuals' mutual fund holdings and trades to examine hypotheses regarding the effects of reputation on individuals' mutual fund investment decisions. We present three key findings that suggest the importance of fund family reputation on mutual fund choice. First, even though our sample investors are purchasing funds through a discount brokerage firm, we find that individuals cluster their investments within particular families. Second, we show that sample investors are significantly more likely to purchase funds from families with which they have previous experience. Finally, we show that individuals' beliefs about funds belonging to older and larger families change slowly, as evidenced by decreased flow-performance sensitivity for these funds.

“The Effects of Organizational Structure on Asset Management”

Massimo Massa (INSEAD) and Lei Zhang (INSEAD)

We study how the strategies and performance of an asset management company are affected by its internal organizational structure. A more hierarchical and complex structure on the one hand reduces the incentives to collect “soft” information and reduces performance. On the other hand, it limits managerial discretion and reduces moral hazard, curbing the incentive of the managers to engage in excessive risk taking. We focus on mutual funds and insurance companies. We have available information on the organizational structure of all the US mutual funds and insurance companies investing in US corporate bonds. We construct two measures of organizational structure: hierarchy and complexity. We show that more hierarchical structures invest less in firms located close to them and deliver lower performance. An additional layer in the hierarchical structure reduces the average performance by 19 basis points per month, while one additional competence reduces the average performance by 3 basis points per month. These effects are particularly strong in the case of insurance-run funds. At the same time, hierarchy and complexity lower the incentives to engage in end-of-the-year risk taking if lagging behind the peers. Moreover, more hierarchical and complex structure tend to herd more and to hold less concentrated portfolios. These findings are consistent with Stein's (2002) theory of organization.

“Is There Hedge Fund Contagion?”

Nicole Boyson (Northeastern University), **Christof Stahel** (George Mason University), and **Rene Stulz** (Ohio State University)

We examine whether hedge funds are more likely to experience extremely poor returns when equity, fixed income, and currency markets or other hedge funds have extremely poor performance than would be predicted by correlations of hedge fund returns with returns on these markets or with returns of other hedge funds (contagion). First, we consider whether extreme movements in these markets are contagious to Arbitrage, Directional, and Event Driven hedge fund indices. Second, we investigate whether extreme adverse returns in one hedge fund index are contagious to other hedge fund indices. To conduct these examinations, we estimate Poisson regressions using both monthly and daily returns on hedge fund style indices. We find no systematic evidence of contagion from equity, fixed income, and currency markets to hedge fund indices, although the Arbitrage index exhibits evidence of contagion from the equity and currency markets for monthly data. In contrast, we find systematic evidence of contagion across hedge fund styles for both monthly and daily data. Our results provide a new perspective on the systemic risks of hedge funds and suggest that diversification across hedge funds may not help as much as correlations would imply in reducing the probability of very poor returns.

“Is a Team Different From the Sum of Its Parts? Evidence from Mutual Fund Managers”

Michaela Bär (University of Cologne), **Alexander Kempf** (University of Cologne), and **Stefan Ruenzi** (University of Cologne).

This paper provides the first empirical test of the diversification of opinion theory and the group shift theory using real business data. Our data set covers management teams and single managers of US equity mutual funds. All our results clearly reject the group shift theory and support the diversification of opinion theory: extreme opinions of single team managers average out and, consequently, teams take less extreme decisions than individuals do. We find that teams follow less extreme risk strategies and less extreme investment styles than single managers do. Consequently, single managers are much more likely to achieve extreme performance ranks.

“Missing the marks: dispersion in corporate bond valuations across mutual funds”

Gjergji Cici (Mason School of Business), Scott Gibson (Mason School of Business), and John Merrick (Mason School of Business)

We analyze important aspects of bond mutual fund pricing by examining the dispersion of month-end valuations placed on identical corporate bonds by different funds for net asset value (NAV) purposes. Our focus on the cross-fund dispersion of valuations on individual corporate bonds offers insights on potential valuation problems at the individual security level as well as fund level. At the individual security level, we characterize how the dispersion across funds in the pricing of bonds for NAV purposes is affected by variables thought to be related to market liquidity – e.g., issue size and credit rating – as well as other bond-specific characteristic such as term to maturity. We also examine the statistical and economic significance of bond-pricing dispersion on crossfund NAV calculations and reported returns. Finally, we show that the trade reporting initiative instituted by the Financial Industry Regulatory Authority (FINRA) through the rollout of its Trade Reporting and Compliance Engine (TRACE) has directly benefited mutual fund investors by increasing the precision of mutual fund bond pricing. In the context of current controversies surrounding the marking of fixed-income security positions during the 2007 credit crisis, our findings of systematic differences in mutual fund marking behavior lead us to conclude that mutual fund NAV pricing practices may deserve further scrutiny and additional transparency.

“Style Investing and the ICAPM”

Michael Stutzer (University of Colorado)

Robert Merton's Intertemporal Capital Asset Pricing Model (ICAPM) predicts that assets' expected returns will be a linear function of the instantaneous expected excess returns (i.e. a "beta" relationship) of the market portfolio, as in the static CAPM, as well as a number of additional “hedge” portfolios. Each additional portfolio is the one most highly correlated with a time-varying (diffusion-generated) state variable that affects investors' indirect utilities (i.e. their Bellman value functions), derived from a sophisticated intertemporal consumption/investment choice problem posited by Merton. Merton defined the state variables to be a subset of the “parameters” of the assets' return processes (i.e. their instantaneous drifts and volatilities), thus causing intertemporal changes in the investment opportunity set. Hence those attempting to theoretically rationalize empirical multifactor regression models of asset returns have tried to establish that the factor portfolios optimally (for Merton's hypothesized consumption/investment problem) hedge Merton's hypothesized intertemporal changes in the investment opportunity set. But the same multifactor relationship will arise no matter how the state variables are defined – they need only enter the Bellman value function of enough asset demanders. Considerable asset demand arises from style investors, i.e. either index or exchange-traded funds that try to match the returns of style-specific benchmark portfolios, or active, professionally managed funds (e.g. mutual, pension, endowment, private client, etc.) that are run with the objective of outperforming specific benchmark portfolios. A style investor's benchmark is a state variable in its value function, so it is (trivially) perfectly correlated with that state variable. Thus the aforementioned hedge portfolio result implies that the most popular benchmark portfolios should appear in the ICAPM relationship. It is argued that this interpretation of the ICAPM is more consistent with both statistical and direct behavioral evidence than the traditional interpretation. But then there is no reason to believe that a positive intercept (“alpha”) in a multifactor regression model indicates superior risk-adjusted fund performance for non-benchmark (e.g. conventional expected utility of wealth) investors, casting doubt on the many normative performance analyses predicated on the traditional interpretation.

“The Impact of Work Group Diversity on Performance: Large Sample Evidence from the Mutual Fund Industry”

Michaela Bär (University of Cologne), Alexandra Niessen (University of Cologne), and Stefan Ruenzi (University of Cologne)

This paper investigates the impact of work group diversity on performance. Analyzing a uniquely large sample of management teams from the U.S. mutual fund industry we find that the influence of diversity on performance depends on the dimension of diversity that is analyzed. Informational diversity has a positive impact on performance, which is driven by tenure diversity as well as educational diversity. Social category diversity has a negative impact on performance, which is mainly driven by gender diversity while age diversity has no strong impact. Our results have important implications for the optimal composition of work groups and for investment strategies of fund investors.

“Spillover Effects of Marketing in Mutual Fund Families”

Joop Huij (RSM Erasmus University) and Marno Verbeek (RSM Erasmus University)

This paper investigates the presence of spillover effects of marketing in mutual fund families. We find that funds with high marketing expenses generate spillovers, and enhance cash inflows to family members with low marketing expenses. In particular, low-marketing funds that are operated by a family with high marketing expenses have substantially larger inflows after positive returns than otherwise similar funds that are operated by a family with low marketing expenses, while they have smaller outflows after negative returns. One way to interpret the spillovers is that they are a by-product of individual fund marketing whereby the entire family is made more visible to investors. An alternative explanation of this observation is that funds with low marketing expenses are directly subsidized by family members with high marketing expenses. We develop and perform a set of tests to evaluate these two alternative hypotheses. The results of all tests support the subsidization hypothesis, and suggest that at least part of the spillovers can be attributed to favoritism. These results suggest that conflicts of interest between investors and fund families have been exacerbated by competition in the mutual fund industry.

“False Discoveries in Mutual Fund Performance: Measuring Luck in Estimated Alphas”

Russel Wermers (University of Maryland), **Laurent Barras** (Imperial College) and **Olivier Scaillet** (University of Geneva)

Prior approaches to identifying skilled funds in a population examine the performance of each fund in isolation, without regard to the role of luck in this multiple fund setting. Our paper develops a new, simple technique to properly account for "false discoveries", or funds which exhibit significant alphas by luck alone. As such, our approach correctly identifies the proportion of funds with truly positive or negative performance in any segment of the cross-sectional alpha distribution, even with cross-fund dependencies in estimated alphas. We find that 19.7% of U.S. domestic-equity funds exhibit truly negative four-factor alphas, while only 1.9% exhibit truly positive alphas. While the unskilled funds reside throughout the left tail, skilled ones are located only in the extreme right tail. Skilled managers are more common among aggressive growth funds and funds with lower turnover and expenses. Finally, by precisely locating truly skilled funds in the cross-sectional alpha distribution, our approach substantially improves the identification of funds with persistent performance.

Campus map

