Soothing Investors: The Impact of Manager Communication on Mutual Fund Flows
Ahmed Guecioueur
INSEAD

Motivation

- Investors tend to be reluctant to bear risk: even those who hold stocks tend to put only a small fraction of their financial wealth in them (Calvet et al. 2023).
- Can investors be encouraged to take more risk? If so, how?
- Gennaioli, Shleifer, and Vishny (2015) hypothesize that trusted financial intermediaries (“money doctors”) can give their clients the confidence to overcome their anxieties and take risks, including through communication.
- Communication by fund managers is prevalent (Hillett, Nissen-Ruence, and Ruence 2021): over 9/10 semi-annual reports contain fund letters. Risk is a major topic.
- Is the money doctors mechanism of anxiety alleviation at work in this setting?

Empirical setting

- Focus on communication by index mutual funds that track the S&P 500 market index to aid identification (Hortacu and Syverson 2004).
- Extract statements related to risk – the very thing investors fear.
- Measure both amount/detail of communication & level of risk conveyed.
- Examine aggregate flows to & from these funds to study investors’ behavior.

Providing more detail about risk encourages risk-taking

- Risk Detail,ij is the log word count about risk. (Total length is controlled for.)
- Effect is present in the cross-section, and over time (i.e. within-fund).
- Examine aggregate flows to & from these funds to study investors’ behavior.

Measuring investor anxiety at a fund-month level

- For readability of letter issued by fund i during month t:
  - Geographic anxiety attitudes based on Google search activity for anxiety-related topics, varying per state & month.

Interpreting the empirical findings

- In the literature, effective risk aversion increases with anxiety (e.g. Kahn and Knutson 2011; Guiso, Sapena, and Zingales 2018)...
- ... and communication reduces anxiety (e.g. Hayward 1975, Hall, Roter, and Katz 1988).
- Consider an investor who holds the (mean-variance-efficient) fraction
  \[ x_i = \frac{E[R_{i,t-1}]}{\gamma_{i,t} \text{Var}(R_{i,t-1})} \]
  of her financial wealth in the risky asset with excess return R_{i,t-1} and (the remainder in the risk-free asset).
- If communication does not shift her beliefs (as shown by my empirical results), the results are instead consistent with a decrease in effective risk aversion:
  \[ \text{Net Flow}_{i,t-1} = \frac{x_i}{\gamma_{i,t} + 1} - 1 \]

Asset pricing implications for the stock market

- In the paper, I show that communication-driven flows are persistent and not due to rebalancing between equity funds \( \Rightarrow \) fresh flows into the stock market \( \Rightarrow \) a $1 inflow increases the value between $1.9-5.5 (Guiso and Knutson 2021; Hartzmark and Solomon 2020).
- Allows me to produce rough counterfactuals for the S&P 500 level over my sample period, based on my flow estimates \( \times \) each estimated market multiplier.
- Effect is responsible for a 27–67 b.p. annual average return.
- Observed S&P 500 annual ex-div. return was 8% \( \Rightarrow \) about 3–6% of that

An explicit test for belief-based persuasion

- Weaker prior (i.e. higher VIX) should produce stronger updates; however...

References