Economic ESP
The Journal of Economic Studies and Policies
Semi-Annual, Vol.9, No.1, Spring & Summer 2022
Issue 16, pp.89-110
Original Article

دوفصلنامهٔ مطالعات و سیاست‌های اقتصادی
دورهٔ نهم، شمارهٔ ۱، بهار و تابستان ۱۴۰۱
شمارهٔ پیاپی ۱۷، صص۸۹-۱۱۰
مقالهٔ پژوهشی

Performance of Individual and Institutional Investors in the Prediction of Mutual Funds' Returns

GholamReza Keshavarz Haddad*
Ali Ebrahimnejad**
Morteza Garoosi***

DOI: 10.22096/esp.2022.123111.1319
Received Date: 15/03/2020 - Accepted Date: 17/01/2021

Abstract

Between 1387 and 1396, mutual funds experienced a significant growth in terms of capital under their management, so that during this period, the volume of their available capital has reached about 800 billion tomans. Over the period, however, the return on these funds was less than both the stock market index and the fixed income funds. This research aims to address the question of whether, despite their poor long-term performance, individual and institutional investors are able to earn higher returns by predicting high-return funds and proper timing of their buys and sells. In technical terms, is money smart in the mutual funds market? To test the ability of investors in these funds, we construct hypothetical portfolios based on fund flows and compare the average monthly return on inflows with outflows and the average fund. The results show that funds with more inflows perform better than the average fund which is consistent with the smart money hypothesis. Comparing the performance of individual and institutional investors separately also shows that individuals and institutional investors, on average, identify funds with higher and lower returns, but there is no evidence that one performs better than the other.

Keywords: Mutual Funds; Smart money; individual investors; institutional investors.

JEl Classification: G23, G11, G23, G23.

* Associate Professor, Faculty of Management and Economics, Sharif University of Technology, Tehran, Iran. Email: g.k.haddad@sharif.edu
** Assistant Professor, Faculty of Management and Economics, Sharif University of Technology, Tehran, Iran. Email: Ebrahimnejad@sharif.edu
*** Graduate of Economics, Faculty of Management and Economics, Sharif University of Technology, Tehran, Iran. Email: leader216@yahoo.com

Bibliography

Berggrun, Luis, and Edmundo Lizarzaburu. “Fund flows and performance in Brazil”, *Journal of Business Research* 68 (September 2015): 199–207.

Berk, Jonathan B., and Richard C. Green. “Mutual Fund Flows and Performance in Rational Markets”, *Journal of Political Economy* 112, The University of Chicago Press (December 2004): 1269–1295.

Brown, Stephen J. et al. “Survivorship Bias in Performance Studies”, *The Review of Financial Studies* 5, (February 1992): 553–580.

Brown, Stephen J., and William N. Goetzmann. “Performance Persistence”, *The Journal of Finance*, (February 1995): 679-698.

Carhart, Mark M. “On Persistence in Mutual Fund Performance”, *The Journal of Finance*, (March 1997): 57-82.

Del Guercio, Diane, and Paula A. Tkac. “The Determinants of the Flow of Funds of Managed Portfolios: Mutual Funds vs. Pension Funds”, *Journal of Financial and Quantitative Analysis*, (February 2002): 523-557.

Ebrahimi Sarveolia, Mohammad Hassan, Nooshin Rostami Asrabadi, and Elmira Faham. “Smart Money Effect in Mutual Funds”, *Financial Research Journal* 18, no. 1 (April 2016): 1-22. [In Persian]

Elton, Edwin J., Martin J. Gruber, and Christopher R. Blake. “The Persistence of Risk-Adjusted Mutual Fund Performance”, *The Journal of Business*, (February 1996): 133-157.

Fama, Eugene F., and Kenneth R. French. “Common risk factors in the returns on stocks and bonds”, *Journal of Financial Economics* 33, (February 1993): 3–56.

Feng, Xunan, Mingshan Zhou, and Kam C. Chan. “Smart money or dumb money? A study on the selection ability of mutual fund investors in China”, *The North American Journal of Economics and Finance* 30 (November 2014): 154–170.

Goetzmann, William, and Roger G. Ibbotson. “Do Winners Repeat?”, *The Journal of Portfolio Management* 20 (December 1994): 9–18.

Grinblatt, Mark, and Sheridan Titman. “Performance Measurement without Benchmarks: An Examination of Mutual Fund Returns”, *The Journal of Business* 66, (Jan. 1993): 47–68.

Gruber, Martin J. “Another Puzzle: The Growth in Actively Managed Mutual Funds”, *The Journal of Finance* 51, (Jul. 1996): 783-810.

Hendricks, Darryll, Jayendu Patel, and Richard Zeckhauser. “Hot Hands in Mutual Funds: Short-Run Persistence of Relative Performance”, *Journal of Finance*, (February 1993): 93-130.

Hsin-Yi, Yu. “Where are the smart investors? New evidence of the smart money effect”, *Journal of Empirical Finance* 19, (February 2012): 51–64.

Ippolito, Richard A. "Consumer Reaction to Measures of Poor Quality: Evidence from the Mutual Fund Industry", *The Journal of Law and Economics*, (February 1992): 45-70.

Jegadeesh, Narasimhan, and Sheridan Titman. "Returns to Buying Winners and Selling Losers: Implications for Stock Market Efficiency", *The Journal of Finance* 48, (February 1993): 65–91.

Keswani, Aneel, and David Stolin. "Which Money Is Smart? Mutual Fund Buys and Sells of Individual and Institutional Investors", *The Journal of Finance*, (February 2008): 85-118.

Khodadadi, Vali and Fatemeh kuchak Shushtari. "Assessing the Effect of the Past Performance Mutual Funds on Investment Net Flow of the Funds in TSE", *Journal of Securities Exchange* 7, no. 27 (2014): 79-101. [In Persian]

Lynch, Anthony W., and David K. Musto. "How Investors Interpret Past Fund Returns", *The Journal of Finance* 58, (October 2003): 2033–2058.

Malkiel, Burton G. "Returns from Investing in Equity Mutual Funds 1971 to 1991", *The Journal of Finance*, (February 1995): 549-572.

Mark Grinblatt, Sheridan Titman. "The Persistence of Mutual Fund Performance", *The Journal of Finance*, (December 1992): 1977-1984.

Odean, Terrance. "Are Investors Reluctant to Realize Their Losses?", *The Journal of Finance*, (February 1998): 1775-1798.

Rahmani, Ali, Mir Hossin Mousavi, and Hanieh Hekmat. "Ex-post Performance and Cash Flow of Mutual Funds in Iran", *Quarterly Financial Accounting* 6, (2014): 1-25. [In Persian]

Salganik-Shoshan, Galla. "The 'Smart Money' Effect: Retail versus Institutional Mutual Funds", *Journal of Behavioral Finance & Economics* (March 2012).

Sapp, Travis, and Ashish Tiwari. "Does Stock Return Momentum Explain the "Smart Money" Effect?", *The Journal of Finance* 59, (February 2003): 2605–2622.

Sirri, Erik R., and Peter Tufano, "Costly search and mutual fund flows", *Journal of Finance*, (February 1998): 1589-1622.

Wermers, Russ. "Is Money Really Smart? New Evidence on the Relation Between Mutual Fund Flows, Manager Behavior, and Performance Persistence", *Working paper*, University of Maryland - Robert H. Smith School of Business (December 2003).

Zheng, Lu. "Is Money Smart? A Study of Mutual Fund Investors– Fund Selection Ability", *The Journal of Finance* 54, (February 1999): 901–933.