Markus Ibert

ESSAYS ON ASSET MANAGEMENT

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"Mutual Fund Managers' Private Portfolios and Skills" studies mutual fund managers' personal investment decisions and how they relate to fund performance.

"Are Mutual Fund Managers Paid for Investment Skill?" investigates the determinants of managerial compensation.

"Firm Fundamentals and Realized Factor Betas" examines time- and cross-sectional variation in factor betas in response to variation in firm fundamentals.

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Markus Ibert

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To my parents, Jutta and Wolfgang.

Foreword

This volume is the result of a research project carried out at the Department of Finance at the Stockholm School of Economics (SSE).

This volume is submitted as a doctoral thesis at SSE. In keeping with the policies of SSE, the author has been entirely free to conduct and present his research in the manner of his choosing as an expression of his own ideas.

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Director of Research
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Stockholm, May 4, 2018

Markus Ibert

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Introduction

This doctoral thesis consists of three independent empirical papers in finance. The common thread is asset management. The first two papers are closely related, use similar data, and investigate the role of mutual fund managers in the Swedish mutual fund industry. The third paper studies heterogeneity in factor loadings and relates it to firm fundamentals.

The first paper **Mutual Fund Managers' Private Portfolios and Skills** uses a unique data set on Swedish mutual fund managers' personal investment decisions. Data on individuals' personal portfolios is available because Sweden levied a wealth tax from 1999 to 2007 and required all residents to file their entire wealth in detail. Consistent with previous studies, I find that the average active mutual fund manager possesses no superior ability to generate abnormal returns (alpha) in managing her fund. That is, the average manager adds no value for the regular fund investor relative to a passive benchmark, for instance a low cost index fund. However, not all managers are alike. The minority of managers who invest (a lot of) personal wealth in the very same funds they professionally manage, that is the managers who have "skin in the game", consistently outperform. The majority of managers do not commit any personal wealth to their own funds, do not outperform their benchmarks after costs, and also invest more conservatively in their personal accounts, that is they hold more cash and more passively managed products. Overall, I conclude that fund managers, contrary to fund investors, know about their ability—or more often lack thereof—and invest their personal wealth accordingly. The results are relevant for the policy maker in evaluating the costs and benefits of requiring managers to publicly diclose the investments they make in their own funds. In light of the poor performance of the average active mutual fund in the past, all else equal investors would have earned larger returns from Swedish mutual funds in the past had they been able to differentiate between managers who eat their own cooking and those who

do not.

The second paper "**Are Mutual Fund Managers Paid for Investment Skill?**" (with Ron Kaniel, Stijn Van Nieuwerburgh and Roine Vestman) has been published in *The Review of Financial Studies*. Again using Swedish administrative data, the paper sheds light on the compensation contracts between firms and managers. Compared with the first paper, the second paper does not aim to predict future fund performance but tries to infer managerial compenation contracts by looking at past fund performance. While much is known about the relationship between funds and fund investors, absent of data on manager compensation the relationship between fund managers and their employers has been a black box. We uncover three main results, each of which is interesting in its own right, and each of which challenges common perceptions. First, we find a lower sensitivity of pay to manager-level assets under management, compared to the fixed fraction of assets under management typically charged by funds. The elasticity of compensation to the revenue the manager generates for his employer is 0.15%, implying there is a far from complete pass through of fund revenues to managerial compensation. In other words, a 1% increase in revenue lowers the manager's share of revenue by 0.85%. Second, we find a surprisingly weak sensitivity of pay to performance: A nontrivial 1% increase in abnormal returns over the past year increases compensation by a paltry $400. Pay to performance sensitivity increases once the components of revenue that are correlated with current and past abnormal returns are accounted for. However, even then it remains economically small and the component of revenue that is unrelated to past fund performance remains the dominant driver of pay. Third, firm-level characteristics, which typically are ignored in the literature, add substantial explanatory power for manager compensation. Overall, the results suggest that the incentives of fund managers and their employers are well aligned, whereas the incentives of fund managers and fund investors are less well aligned. Similar to the first paper, the results do not paint a very rosy light of the state of the active fund industry.

The third paper is "**Firm Fundamentals and Realized Factor Betas**" (with Michael Halling and Martin Lenz). The paper focuses on time series variation of factor loadings for common risk factors. We ask whether significant changes in firm fundamentals, for instance caused by management activities, are reflected in standard risk measures and find limited evidence that they are. Surprisingly, firm fundamentals are dominated in terms of explanatory power by an unobserved time invariant firm-specific component which

leads to stable factor loadings: Stocks with high and low factor loadings, respectively, tend to remain as such for a decade.