HETEROGENEOUS ASSET PRICING MODEL PREFERENCES BY INVESTOR TYPE:
EVIDENCE FROM SEPARATE ACCOUNTS

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MAIN FINDINGS
1. For US Separate Account composites, Morningstar ratings is the best predictor of flows
2. There is a slight increase in the degree of sophistication of the model investors use over time
3. Investors in value funds, growth funds, and blend funds behave similarly to each other in terms of flow drivers
4. Passive investors also appear to care about Morningstar ratings when allocating capital
5. There is no consistent outperformance (either net or gross) by the separate account composites

DATASET DESCRIPTIONS

SEPARATE ACCOUNTS
- Actively managed and passively managed US Equity Separate Account Composites from Morningstar
- Separate account investors such as institutions, endowments, sovereign wealth funds, and pension funds with an average minimum investment of $10mm
- A Composite is an aggregation of one or more separate accounts running the same strategy under the same investment manager
- Novel dataset that has not been previously used in the literature
- Dataset includes over 3,000 composites

FLOW SIGN TEST FOR SEPARATE ACCOUNTS

- MS Rating >= 5
- MS Rating >= 4
- MS Rating >= 3
- Fama-French 3 Factor
- Fama-French-Carhart 4 Factor
- CAPM
- Benchmark-Adjusted
- Market-Adjusted
- Excess Return

MUTUAL FUNDS
- Actively managed and passively managed US Equity Mutual Funds from Morningstar
- Benchmarked to the major S&P, Russell, and Nasdaq indices
- Benchmark return data also comes from Morningstar
- Dataset includes over 3,000 mutual funds
- As for Separate Account Composites, remove funds with AUM less than $10mm or flows less than 90% or greater than 1000%

RELATED LITERATURE
- Berk and van Binsbergen (2004, 2016, 2016) proposed a theoretical framework saying that mutual fund managers do have skill, but it should be measured as value added rather than by alpha; introduced the flow sign test.
- Barber, Huang, and Odean (2016) find that CAPM supercedes factor models in explaining mutual fund flows
- Ben David, Li, Rossi & Song (2019 wp) showed that Morningstar ratings supercede CAPM and factor models in explaining mutual fund flows
- Evans and Sun (2020): Morningstar rating change of June 2002 affected aggregate risk adjustment by retail mutual fund investors

INVESTOR PREFERENCES BY STYLE AND OVER TIME
PASSIVE FUNDS: For passive funds, 5-star Morningstar rated funds received a positive inflow next period a statistically significant 63% of the time
INCREASE IN SOPHISTICATION: Over the second half of the sample, the Fama-French-Carhart 4 Factor model was the only performance metric to become more predictive of flows relative to the first half of the sample