Comments on: Hurdle Rate, the Zero Lower Bound, and Investors' Active Risk Taking by Woon Sau Leung and Zhongyan Zhu

Clinton Watkins
Graduate School of Economics, Kobe University

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"I do believe low rates hurt savers worldwide ... Retirement and the fear of retirement is the greatest problem we have in this country, ... Since the financial crisis, ... men and women over 50 ... they have to work longer because they don't have the nest egg that they need to live retirement in dignity"

Brief Summary

- The paper examines whether flows into U.S. fixed income mutual fund flows are best explained by past performance or their level of credit risk during both a positive interest rate environment and when monetary policy hits the zero rate lower bound, controlling for a number of other variables including lagged flows, fund size, expense ratio, age, and turnover ratio.
- They find significantly greater flows to riskier fixed income mutual funds during the zero lower bound period.
- An interesting research paper that I enjoyed reading.

Motivation – the “Hurdle Rate”

- The idea of heterogeneous investor “hurdle rates” is invoked to describe investor behaviour that may lead to changes in fund flows.

- Plausible approach, but is the hurdle rate best cast as a behavioural bias, investor expectations being stuck in a past world of higher yields, a rational expectation of the net present value of post retirement liabilities (in the vein of Sharpe and Tint (1990)), or other?

- The article would be enhanced with a formal model of the hurdle rate and investor mutual fund search behaviour, and a more direct link to the empirical analysis.

Motivation – Destabilising Mutual Fund Flows

- The idea that flows into mutual funds may abruptly reverse with substantial volume due to the business or monetary policy cycle and destabilise financial markets has a long history, but not a great deal of empirical support. See for example, Collins and Plantier (2014).
    - Reflect this literature more broadly.
- Paper contributes to the literature suggesting that flows are not likely to be destabilising.
    - Develop the implications of the research regarding the likelihood of destabilising flows.
    - See Banegas et al. (2016) for recent work suggesting monetary policy may contribute to potentially destabilising flows.

Observations on the Data

- The government and corporate funds have a surprisingly similar asset allocation at the beginning of the sample, from around 2000 to 2003. See Table III.
  - Does including this data influence the results? Should observations from 2000 to 2003 be excluded?
- Is it a good idea to exclude the bottom 20 percent of funds by size?
  - Avoiding selection bias is reasonable, however size may hinder performance.
- Are returns net of costs and does this matter?

Mutual Funds and the Portfolio Balance Effect

- Quantitative Easing (QE) pushes investors from safe assets to risky assets:
  - Low capital gain expectations and low income from safe assets.
  - ***Decline in market risk of safe assets.***
- The paper focusses on flows moving toward higher credit risk mutual funds, proxied by the two types of funds.
  - Are investors responding to, or compensating for, a decline in market risk of safe asset mutual funds?
- Goldstein et al. (2018) find portfolio rebalancing occurred both within and across funds, primarily by investors moving to riskier funds than mutual fund managers taking more risk.
  - Consistent with Leung and Zhu, paper contributes to this area.
- Relate the motivation, model and results to QE and the portfolio balance effect as well as the policy rate at the ZLB.

Model Specification – Lags

- Models are specified including one lag of performance measures.
- Is this sufficient to capture the dynamics?
- VAR models used in the literature with several lags of past returns.

- *Thank you for the opportunity to review the paper.*

References

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