
Did your active fund underperform? Maybe a rich kid manages it

By Editorial Staff Thu, Dec 8, 2016

'Managers from families in the top quintile of wealth underperformed managers in the bottom quintile by 2.16% per year,' according to a study by economists at the University of Michigan and the University of New South Wales.

People with relatively modest or obscure family backgrounds can reach the top rungs of the fund management business—but only a few do so, and only if they deliver better returns than their colleagues, according to a new paper from the National Bureau of Economic Research.

In “Family Descent as a Signal of Managerial Quality: Evidence from Mutual Funds,” Denis Sosyura of the University of Michigan and Oleg Chuprinin of the University of New South Wales found that mutual fund managers from poor families consistently achieve better investment results than those from wealthier backgrounds.

The researchers found that fund managers from wealthier backgrounds delivered “significantly weaker performance than managers descending from less wealthy families. Managers from families in the top quintile of wealth underperformed managers in the bottom quintile by 2.16% per year.” The researchers also found significant differences in promotion patterns and trading styles between these two types of fund managers.

This doesn’t necessarily mean, however, that underprivileged people make better fund managers. It may not say anything at all about people from poor families in general. It may only mean that exceptional performance can overcome the handicap of a poor background. Or it may even mean that the fund management business isn’t a meritocracy.

“The researchers emphasize that these findings do not imply that those from poor families are in general better at their jobs than those with a more fortunate background,” wrote a reviewer of the study. “Rather, because individuals from less-privileged backgrounds have higher barriers to entry into prestigious positions, they argue, only the most skilled advance and succeed.”

Previous studies about the relationship between managers’ upbringing and their performance have focused on educational differences, including whether the managers attended elite universities or had access to education-related networks of influential people who could later help boost their careers. Such studies tend to find that managers with a stronger educational background tend to deliver better performance.

In this study, the economists relied on data from individual U.S. Census records on the wealth and income of managers' parents. The researchers also identified and verified fund managers via Morningstar, Nelson's Directory of Investment Managers, and LexisNexis Public Records.

They identified hundreds of fund managers, most born in the mid-1940s, whose parents' Census records were in the public domain. They then examined the performance of hundreds of actively managed mutual funds focused on U.S. equities between the years 1975 and 2012.

Indeed, in tracking career trajectories of mutual fund managers, they find that the promotions of managers from well-to-do families are less sensitive to their performance.

In other words, managers who are born rich are more likely to be promoted for reasons unrelated to performance.

In contrast, those born into poor families are fewer in number and are promoted only if they outperform. Fund managers from less-affluent families who do make it into top ranks are also more active on their job: they are more likely to trade and deviate from the market, whereas those born rich are more likely to follow benchmark indexes.

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