

Discussion of:  
*Money in the right hands*  
by Aleksandra Rzeźnik and Rüdiger Weber

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- The paper combines
  - the setting of mutual fund fire sales (Coval and Stafford, 2009), which has been used to study non-fundamental price pressure on portfolio stocks,
  - with an investigation of the demand side (inspired by, e.g., Koijen and Yogo, 2019).
  - In the latter lies the contribution of this paper.
- In its main analyses, the paper compares different versions of two key variables:
  1. Stock-level fire sale discounts during fire sale event quarters,
  2. with specialized demand coming from non-fire sale mutual funds during the same quarter.

### 1. Stock-level fire sale measure.

- Coval and Stafford (2009) show that selling by financially distressed mutual funds leads to transaction prices below fundamental value. Also, funds with large inflows behave as if they too are constrained and buy more of what they already own.
- Edmans, Goldstein, and Jiang (2012) show that price pressure induced by mutual fund selling affects a stock's takeover probability.
- Wardlaw (2020) suggests improved measure removing impact of a stock's realized return during outflow quarter.

⇒ This paper uses the mutual fund fire-sale measures from Wardlaw (2020).

### 2. Proxies for specialized demand (measure of high-valuation demand by peers):

- SPEC FLOW: Flow to funds holding a stock.
  - IND FLOW: Flow to funds not holding the stock but close peer.
  - GEO FLOW: Within top quintile of flow to funds within 100km from headquarter of stock.
  - ACTIVE SHARE: Cremers and Petajisto (2009) active share measure.
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- Include only active non-fire sale mutual funds.
  - Aggregate proxies at the stock-quarter-level.
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- SPEC INDEX: combination of the four measures as sum of individual z-scores.

⇒ This paper: How does specialized demand from non-fire sale mutual funds effect price pressure on stocks held by mutual funds facing large investor redemptions?

## Main findings: specialized demand and price pressure

- Stocks with higher specialized demand experience smaller fire sale discounts.
  - 1-SD increase in SPEC FLOW reduces fire sale discount by 12% FTS / 30% (FTV).
  - 1-SD increase in ACTIVE SHARE reduces discount by 28%.
  - 1-SD increase in IND FLOW translates into discount of 17%.
  - 1-SD increase in GEO FLOW reduces discount by 23%.
  - 1-SD increase in SPEC INDEX: 50% reduction in fire sale discount (or 4pp in absolute terms).
- Can you standardize specialized demand proxies to allow for easier interpretation of regression results in Table 1?
- You present results for your 4 specialized demand proxies in a different order than you introduced them. You could always have the same structure to make it even simpler for the reader.
- Which of the four is the most important proxy for specialized demand? Run your main regression with all four variables. Is one of them spanned by a combination of the others?

- Adverse selection and stock quality.
  - Specialized demand could capture underlying stock quality and adverse selection.
  - However, no relationship between specialized demand and measures related to asymmetric information.
    - Negative earnings surprise next quarter.
    - Llorente et al. (2002) information asymmetry measure.
    - One-quarter ahead short interest.
  - Also, prices revert to pre-fire sale levels indicating price discount not reflecting information about low stock quality.
- Disruptions in ex-ante efficient allocation.
  - Specialized funds increase share holdings of fire sale stocks.
  - After fire sale, more stocks held by non-specialized investors with lower valuations and less elastic demand. Prices drop (temporarily).

## Comment 1: Specialized demand measure SPEC FLOW

- You assume that an active fund manager holding a given stock is likely to generally consider it a good investment.
- What about inelastic demand driven by benchmarking? (Pavlova and Sikorskaya, 2023)
- Most active fund managers would hold every stock in the benchmark (unless the weight in the index is tiny) to hedge against departing too much from the fund's peers.
- If an active fund manager heavily underweights a stock relative to the benchmark arguably she is not too excited about this stock.
- Stronger signals for specialized demand in my opinion:
  - An active fund holds a stock outside of its benchmark.
  - The fund overweights the stock relative to its benchmark.

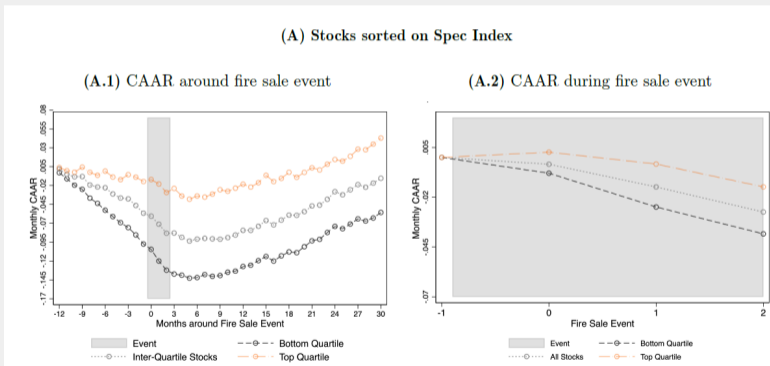
## Comment 2: Sample

- Why do you exclude sector funds?
- Berk and van Binsbergen (2015) show that we exclude a large share of fund AUM by looking at domestic active equity funds only (e.g., 3x3 style box of fund categories in Morningstar).
- Your IND FLOW variable builds on the intuition that funds may be specialized with respect to a fire-sale firm's industry and may step in to buy peer companies to current portfolio holdings.
- Sector funds seem to be a prime example of such specialized funds with specialized demand for fire-sale firms in their target industry.



## Comment 3: Return dynamics

- Stock prices revert quicker to pre-fire sale levels when specialized demand is high.
- The effect is transient and return differences for stocks with high vs. low specialized demand disappear within 24 months. (discount rate shock)



- Fix CAAR=0 at month 0? Otherwise, the reader cannot see immediately that the price difference disappears (only when looking at your regressions).

## Comment 4: Russell index reconstitutions

Year	Ranking date	Announcement date	Effective date
2004	2004-05-28	2004-06-11	2004-06-25
2005	2005-05-27	2005-06-10	2005-06-27
2006	2006-05-31	2006-06-16	2006-07-03
2007	2007-05-29	2007-06-11	2007-06-25
2008	2008-05-30	2008-06-13	2008-06-30
2009	2009-05-29	2009-06-12	2009-06-29
2010	2010-05-28	2010-06-11	2010-06-28
2011	2011-05-27	2011-06-10	2011-06-27
2012	2012-05-25	2012-06-08	2012-06-25
2013	2013-05-31	2013-06-14	2013-07-01

- You regress stock returns in June on your SPEC INDEX and find that the availability of specialized demand positively correlates with returns.
- Passive funds can only sell on/after the effective date. Not always in June.
- R1000 addition: Specialized active investor who expects negative price pressure induced by passive funds selling stocks included to the Russell 1000 could sell at the announcement date and buy back from passive funds at the effective date.
- Are specialized investors refraining from front-running? Or are they willing to buy back at a higher price compared to other investors?

- p.8: “specialization is a fund-stock specific property [rather?] than a fund characteristic”
- Table 2 and others show month fixed effects and standard error clustering in the table but mention quarter fixed effects and standard error clustering in the text.

# Conclusion

- Very interesting paper and I recommend reading it!
- Most results may be not too surprising but very relevant and important to document.
- Policy implication: should mutual funds have access to CB lending?
- Unexplored: relationship between positive stock-level price pressure and availability of specialized investors?

Good luck with the paper!