Visible Hands: Professional Asset Managers'Expectations and the Stock Market in China

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May 9th, 2025

Motivation

- To what extent do professional fund managers' decisions impact market dynamics?
  - They play a significant role in Chinese financial markets, mirroring a trend that began earlier in some other economies.
  - Expected macroeconomic growth is an important factor in investment decisions, given the potential impact on companies'earnings growth trajectory and investors' willingness and ability to bear risks.
  - The significant role of state-owned enterprises (SOEs) in the market make investors concern about economic growth.
- Existing Research Gaps
  - Short data
  - focus on macroeconomic news rather than investor expectations.
- This Paper
  - Examines the impact of these expectations on investment actions and stock prices
  - Employs textual analysis to measure fund managers' growth expectations.

Research Queation

- How professional fund managers'growth expectations affect their equity investments and the consequent effects on prices.
  - when expecting strong economic growth, fund managers increase the equity share and raise the stock market beta in their portfolios
  - active fund managers in China help move stock prices closer to underlying fundamentals

Design

Motivation

1. To what extent do Fund Managers' decisions impact market dynamics?
2. Expected macroeconomic growth is an important factor in investment decisions

Research Question

How **professional fund managers' growth expectations** affect their equity **investments** and the consequent effects on **prices**?

Measure growth expectations

- textual analysis
- annual reports

Result

- pessimistic managers decrease equity allocations and shift away from more-cyclical stocks
- active fund managers in China help move stock prices closer to underlying fundamentals

Contribution

1. literature examining the effect of expectations on investments.
    - expectations of large fund families, public pension funds
    - focuses on equity and mixed funds'growth expectations and implications for the stock market
2. literature on how stock prices respond to changes in macroeconomic information.
    - Prior: the price impact of unexpected macro news
    - Extend: macroeconomic expectations are associated with changes in stock prices.
3. literature on the determinants of price informativeness in stock market
    - Prior: enforcement of law, product market structure, transparency of information
    - Extend: macroeconomic research by active mutual fund managers

Sample

- 2008Q2 and 2020Q2 from a panel of fund managers that includes 4,503 actively managed equity and mixed funds
- Growth expectation measurement
  - Creates a dictionary of words related to GDP growth.
  - Assigns numerical scores to reflect the strength and direction of expectations.
  - Computes the growth expectation measure based on the combination of these words.

Panel A: Summary statistics of growth expectations									
Variable	#Reports	#Forecasts	Mean	Std. Dev.	Min	p25	Median	p75	Max
All	73,361	29,852	-0.02	0.79	-1.00	-1.00	0.00	0.94	1.00
Mixed Funds	52,699	22,059	-0.04	0.78	-1.00	-1.00	0.00	0.94	1.00
Equity Funds	20,662	7,793	0.03	0.79	-1.00	-1.00	0.00	0.94	1.00

Actions: Managers' Growth Expectations and Investment

- Positive correlation between equity share and growth expectation
- S_t^i is equity share or stock market beta;
- $E_t^i(\Delta y_{t+1})$ is the fund manager's growth expectation

$$S_t^i = \alpha + \eta E_t^i(\Delta y_{t+1}) + X_t + Z_t^i + \chi^i + \epsilon_t^i,\ S \in \{Equity\ Share, Beta\},$$

	(1)	(2)	(3)	(4)
Dependent Variable :	Equity (%)		Beta	
Growth Expectation	1.116***	0.442***	0.020**	0.007***
	(3.78)	(3.36)	(2.67)	(2.81)
Lagged Log(TNA)	-1.555***	-1.817***	-0.020***	-0.025***
	(-4.31)	(-5.46)	(-3.34)	(-3.58)

Actions: Managers'Growth Expectations and Investment

- fund managers increase their allocation of equity investment in pro-cyclical industries and SOE stocks

	(1)	(2)	(3)	(4)
Dependent Variable :	$\frac{Pro-Cycle}{Equity}$ (%)		$\frac{SOE}{Equity}$ (%)	
Growth Expectation	0.775***	0.346***	1.546***	0.217
	(3.44)	(3.12)	(3.45)	(1.00)
Lagged Log(TNA)	0.219	0.131	0.599	0.036
	(1.42)	(0.81)	(1.34)	(0.08)

Effects on Prices

- Greater (lower) optimism about economic growth encourages managers to take on more (less) stock market risk, pushing up (down) stock prices.
- index funds do not actively adjust their portfolios due to their investment mandate

	(1)	(2)
Dependent Variable :	Log Price-Dividend Ratio	
Active Consensus Growth Expectation	$\boxed{0.319^{**}}$	0.446^{***}
	$\boxed{(2.53)}$	(3.87)
GDP Growth Rate	0.031^{***}	0.026^{***}
	(2.99)	(2.79)
Lagged Log Price-Dividend Ratio	0.542^{***}	0.566^{***}
	(6.75)	(6.69)
Index Consensus Growth Expectation		$\boxed{-0.166^{*}}$
		$\boxed{(-2.00)}$

Asymmetric Price Impact of Positive and Negative Growth Expectations

- Asymmetry is consistent with the limitations that short-sale constraints
- Forecasting managers' growth expectations move stock prices is by the managers' trading decisions

	(1)	(2)	(3)
Dependent Variable :	Stock AR in March or September		
Sample :	Negative HGE	Positive HGE	All
Holders' Growth Expectation (HGE)	1.938***	0.048	1.513***
	(5.68)	(0.15)	(5.30)
Positive × Holders' Growth Expectation (HGE)			-1.829***
			(-4.26)
Positive			-0.474*
			(-1.81)
Forecasting Managers' Holdings (FMH)	-0.091*	0.051	-0.033
	(-1.81)	(1.12)	(-1.00)
GDP Growth Rate	-0.119*	-0.274***	-0.214***
	(-1.93)	(-5.05)	(-5.61)

Price informativeness

- Active Manager Holding is positively correlated with price informativeness
- Forecast-consistent trading is positively correlated with price informativeness.
- $\overline{PI}_{b,t}$ is the average price informativeness per ventile in period t; the key regressor
- $\overline{M}_{b,t}$, is the average of fund managers'holdings or trading per ventile period;

$$\overline{PI}_{b,t} = a_0 + a_1 \overline{M}_{b,t} + Z_{b,t} + \gamma_t + \chi_b + \epsilon_{b,t}, \;\; b \in \{1, 2, \cdots, 20\}$$

	(1)	(2)	(3)	(4)	(5)
Dependent Variable :	Price Informativeness				
Active Manager Holding	$\boxed{0.546^{***}}$		0.353^{***}		-0.054
	$\boxed{(6.21)}$		(2.71)		(-0.22)
	$\boxed{[11.2\%]}$		[7.3%]		[-1.1%]
Active Forecast-Consistent Trading		$\boxed{1.587^{***}}$	0.794^{**}		0.640
		$\boxed{(5.92)}$	(2.01)		(1.59)
		$\boxed{[12.1\%]}$	[6.0%]		[4.9%]
Active Forecasting Manager Holding				0.991^{***}	0.813^{**}
				(6.68)	(2.01)
				[13.7%]	[11.2%]

Ideas

- How to differentiate fund's active expectations or the positive sentiment of the fund manager?
- Professional fund managers should have similar macro expectations. However, due to differences in their investment areas, their sentiments can vary significantly.
- Construct interaction terms between major financial events, bull and bear markets, and fund managers' macroeconomic expectations, analyze their impact on the market.
- Fund managers' macroeconomic expectations and herding behavior.