

Capital Flow Dynamics and Strategic Risk Management in Mutual Funds: Deciphering Managerial Decision-Making

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Abstract

This study investigates the relationship between mutual fund capital flows and managers' risk management decisions, presenting an original methodology to distinguish active managerial choices from passive portfolio segments. We introduce a set of metrics—Risk-Attitude-Purchases (RAP), Risk-Attitude-Sales (RAS), and Risk-Attitude-Trades (RAT)—to discern risk preferences under varying capital conditions, focusing on ESG compliance, Illiquidity, and Mispricing. Our findings demonstrate that managers strategically adjust their holdings from asset characteristics in response to capital inflows or withdrawals, optimizing between immediate fund performance and long-term potential. The research further explores how these risk-adjustment strategies vary between funds with different investor bases, revealing a tailored approach to the distinct expectations of retail versus institutional clients. The analysis confirms the validity of our findings, mitigating concerns about portfolio manipulation and window dressing. This contribution aids in understanding the complex strategies underpinning fund management in an ever-changing financial landscape.

Keywords: Mutual Fund Risk Management, Capital Flow Dynamics, trades, Managerial Decision-Making, Risk Preferences, Mispricing, Illiquidity, ESG, Investment Strategies, and Risk Shift.

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