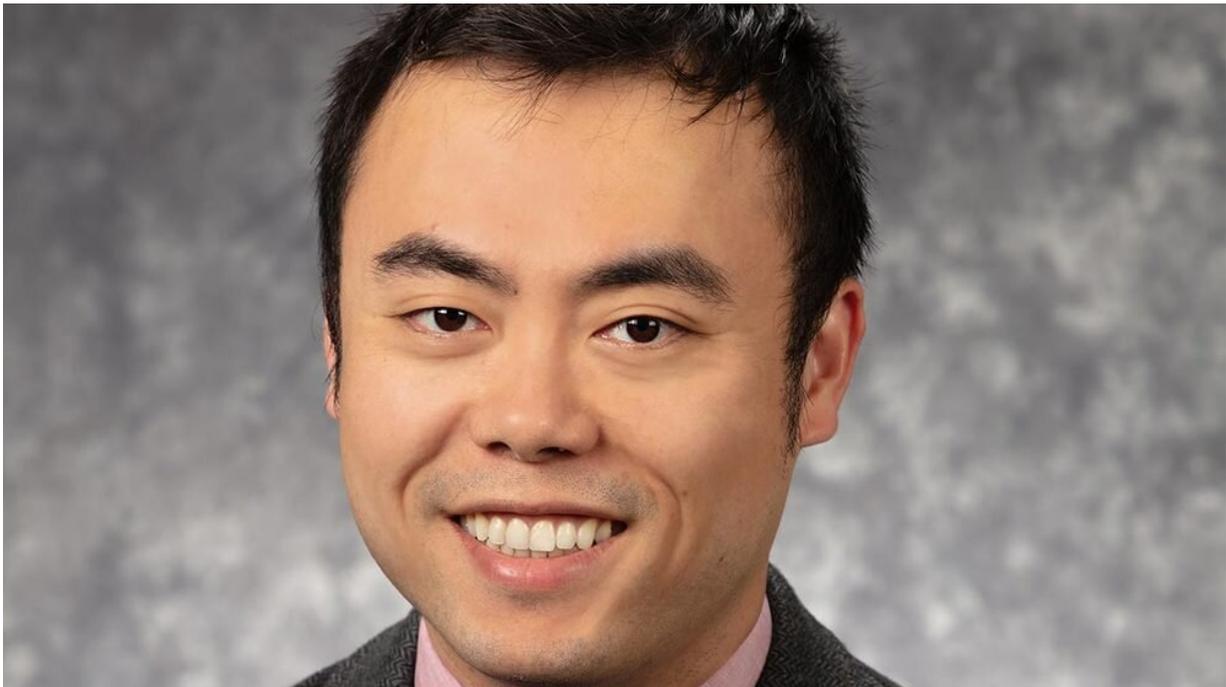


Study finds mutual fund managers use their networks for info on insider trades

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Huaizhi Chen

Insight on insider trades is tough to come by, but some mutual fund managers have figured out a way to leverage their networks—and the Securities and Exchange Commission's EDGAR servers—to better read between the lines when tracking stocks.

New research from the University of Notre Dame found that these

tracked insider trades can predict future firm returns, with the stocks bought by a fund manager after a tracked insider buy outperforming other firm purchases.

"IQ from IP: Simplifying Search in Portfolio Choice," forthcoming in the *Journal of Financial Economics* from lead author Huaizhi Chen, assistant professor of finance in Notre Dame's Mendoza College of Business, examined the monitoring behavior of individual institutional investors at companies like Fidelity Investments and Vanguard Group Inc. using web traffic on the SEC's EDGAR servers from 2004 to 2015.

Chen, along with his co-authors Lauren Cohen of Harvard Business School, Umit Gurun of the University of Texas at Dallas, Dong Lou of the London School of Economics and Christopher Malloy of Harvard Business School, identified which corporate insiders were being tracked based on what trading information portfolio managers downloaded off the site. Using the IP addresses connected with the download, they were able to identify the individual fund managers and compare their portfolio decisions with the behavior of the corporate insider they tracked.

They discovered that when a firm bought after a tracked insider did so, the stock outperformed the firms' other purchases by an annualized abnormal return of 12 percent rate per year. These abnormal returns do not reverse but continue to accrue in following quarters. And when fund managers opted not to buy or sell when a tracked insider did so, the researchers noted, it implies that those insider trades "should have less predictive ability for future returns."

The researchers noticed that the insiders being tracked shared certain characteristics.

"We find that institutional managers tend to track members of the top

management teams of firms (CEOs, CFOs, presidents and board chairs) and tend to share educational and location-based commonalities with the specific insiders they choose to follow," Chen said. "They tend to track accountants, people living close to them and people they went to school with. Collectively, our results suggest that the information in tracked trades is important for fundamental firm value and is only revealed following the information-rich dual trading by insiders and linked institutions."

The study also finds "the average tracked stock that an institution buys generates annualized alphas of between 9-18 percent relative to the purchase of an average non-tracked stock."

Chen's [research paper](#) took first place in the 17th annual Dr. Richard A. Crowell Prize, which recognizes new and cutting-edge [academic research](#) that connects theory and practice in the field of quantitative investing.

"I think the main contribution of the research is to understand how these active asset managers construct and manage their portfolios based on all of the information available," said Chen, who researches in the area of behavioral finance. "In principle, there isn't a lot of direct evidence that managers actively acquire information to be used in portfolio formation. Our paper provides a first step in understanding that."

Provided by University of Notre Dame

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