Abstract

Using micro-level data on mutual funds from different financial centers investing in equity and bonds, this paper analyzes how investors and managers behave and transmit shocks across countries. The paper shows that the volatility of mutual fund investments is quantitatively driven by investors through injections of capital into, or redemptions out of, each fund, and by managers changing the country weights and cash in their portfolios. Both investors and managers respond to returns and crises, and substantially adjust their investments accordingly.

These mechanisms generated large capital reallocations during the global financial crisis. Their behavior tends to be pro-cyclical, reducing their exposure to countries experiencing crises and increasing it when conditions improve. Managers actively change country weights over time, although there is significant short-run "pass-through," meaning that price changes affect country weights. Consequently, capital flows from mutual funds do not seem to stabilize markets and instead expose countries to foreign shocks.