PORTFOLIO RISK AND PERFORMANCE

The Small World of Investing: Board Connections and Mutual Fund Returns

May 1, 2007

Information moves security prices. How information disseminates through agents in financial markets and into security prices, though, is not as well understood. We study a particular type of this dissemination in the form of social networks.

Social networks are network structures composed of nodes (usually people or institutions) that are connected through various social relationships ranging from casual to close bonds. In the context of information flow, social networks allow a piece of information to flow, often in predictable paths, along the network. Thus, one can test the importance of the social network in disseminating information by testing its predictions on the flow of information.

Our results reveal a systematic pattern, in both holdings and returns, across the entire universe of U.S. mutual fund portfolio managers: fund managers place larger concentrated bets on companies to which they are connected through an education network and perform significantly better on these connected positions than on nonconnected positions.

Our results indicate a portfolio of connected stocks held by managers outperforms nonconnected stocks by up to 7.8% per year. This connection premium is not driven by firm, fund, school, industry or geographic location effects and is not driven by a subset of the school connections (e.g., Ivy League schools). We find that most of this premium occurs around corporate news events such as earnings announcements, lending support to the hypothesis that the excess return earned on connected stocks is driven by information flowing through the network.

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