Hedge Fund Managers Driving Minivans Outperform

Stockholm (HedgeNordic) – Allocators should consider adding another variable into their decision-making process when selecting hedge fund managers. According to a recent study, hedge fund managers who possess powerful sports cars make riskier investments and generate less alpha compared to managers owning more practical vehicles such as minivans.

The study titled "Sensation Seeking and Hedge Funds" was conducted by four university researchers using public records of vehicle purchases, which were used to match 1,774 cars to 1,144 hedge fund managers based in the United States. Relying on the premise that the purchase of a powerful sports car signals an inclination for sensation seeking (i.e. a personality trait characterized by the search for varied, novel, complex and intense sensations and experiences), the researchers find that sensation-seeking managers trade more frequently, load up on more non-index stocks, employ more distinctive strategies, as well as prefer lottery-like stocks.

After controlling for a number of factors driving fund performance, the study finds that hedge fund managers who own sports cars underperform managers without sports cars by 2.92 percent per year. Managers owning minivans, meanwhile, outperform non-minivan drivers by 3.22 percent per year. The researchers also show evidence that fund managers who drive sports cars take on more investment risk (two variables were used to define risk, one of which was the standard deviation of monthly returns) without being compensated with higher returns. In contrast, minivan drivers running hedge fund vehicles deliver less volatile returns than those generated by other drivers managing funds.

Overall, hedge funds managers in possession of cars with so-called pro-sensation attributes (sports car ownership, horsepower, and torque) are found to deliver lower Sharpe and information ratios than do managers who own cars with anti-sensation attributes (minivan ownership, passenger volume, and safety rating). For instance, managers who own sports cars generate annualized Sharpe and information ratios that are 0.39 and 0.29 lower on average than those generated by other managers.

In addition to underperforming managers who own more practical cars, money managers in possession of sports cars are more likely to terminate their funds, or disclose regulatory actions and criminal violations. "These results suggest that sensation-seeking managers may be more predisposed to fraud," the researchers write. "Our results empirically validate the advice given by some hedge fund allocators to avoid managers who drive fancy sports cars," the study concludes.

Hedge fund investors are susceptible to sensation seeking themselves, the researchers find, as managers of funds of hedge funds (FoFs) who own sports cars tend to invest in sensation-seeking hedge fund managers. Sensation-avoiding managers of FoFs, meanwhile, tend to avoid sensation-seeking hedge funds, with FoF managers who own minivans taking on less risk than other managers. The personality traits of hedge fund managers are indeed affecting their investment behavior.