Behaviour Change Among Managers on Winning or Losing Streaks

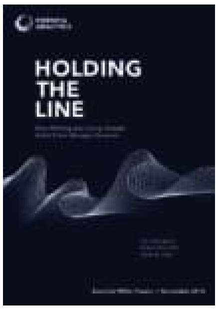
Stockholm (HedgeNordic) – By now, the investment management industry should be well aware that certain behavioural biases and traits affect the process of making investment decisions. New research provides evidence that active equity portfolio managers exhibit a change in behaviour after experiencing a winning or losing streak, which tends to hurt performance.

Using trade and holdings data from 29 active equity portfolios across 21 firms, five of which were hedge funds, from 2008 to the present, behavioural data analytics provider Essentia Analytics found that half of the fund managers showed some change in behaviour after experiencing a winning or losing streak of five consecutive days. The majority of the fund managers on a winning streak traded less frequently and made fewer but worse investment decisions, whose impact was alleviated by the reduced turnover.

Managers on a losing streak, on the other hand, typically traded more frequently and in larger volumes. The decisions made by managers on a losing streak tended to destroy even more value, according to the white paper titled “Holding the Line: How Winning and Losing Streaks Affect Fund Manager Behavior.” “A manager on a losing streak was nearly twice as likely to change behaviour as a manager on a winning streak – and almost certain to change it by trading more,” the paper writes. Some managers were found to trade three to four times more frequently when losing. The top 35 percent of managers who traded significantly more on a losing streak was found to destroy 35 basis points of alpha on average each year. The results show fund managers exhibit risk-seeking behaviour in the domain of losses, a tendency to double down to avoid the possibility of recognising a capital loss.

“If you ask most fund managers or traders whether they behave differently, vis-a-vis investment decision-making, when they are on a winning or losing streak, they will say ‘probably.’ But very few could tell you exactly how their behaviour changes, or whether the quality of their decisions actually improves or deteriorates,” says Essentia’s founder and CEO, Claire Flynn Levy. The results of the analysis are intended to help portfolio managers become aware of certain behavioural traits that affect the decision-making process and make more informed investment decisions.

The complete white paper can be downloaded here: www.essentia-analytics.com/holding-the-line/



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