The Risk of Oursourcing: How External Advisors Influence Mutual Fund Performance

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Northern Finance Association

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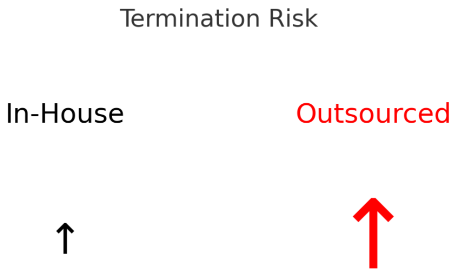
The paper in one slide



- Mutual funds often outsource to external advisors $\Rightarrow$ **higher termination risk**.

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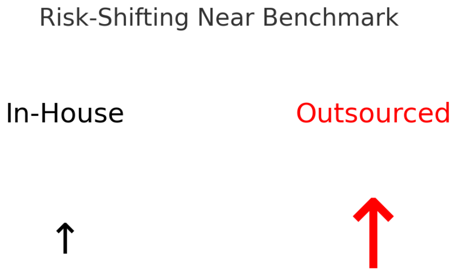

- Outsourced advisors **dial up mid-year risk** near the benchmark.

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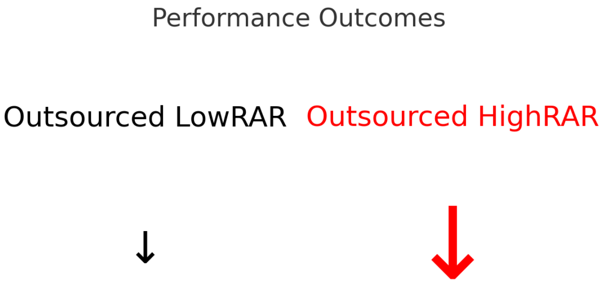

- This **drives much of the underperformance** of outsourced funds.

Major Point 1: Tighten and Clarify

Point

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    - **The conclusion begins on page 51!**

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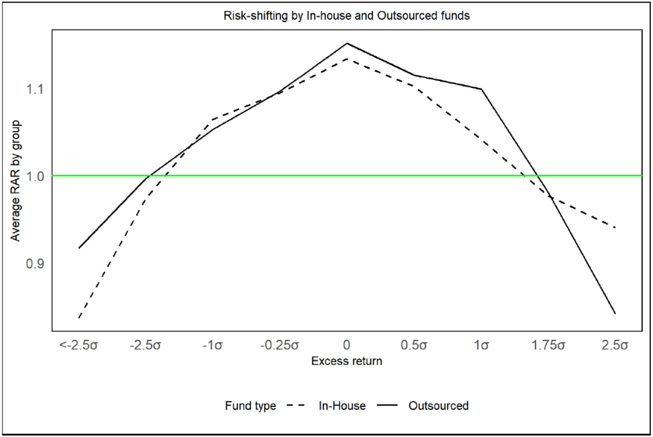
- Instrument setup and details about validity.
- Hypothesis development section is very long.
- I took lot's of "move to appendix" notes.
- I don't think the *Nexus* focus is necessary.
- Remove details about histograms.
- Cite Chevalier and Ellison (*JPE* 1997).

Major Point 2: Dig Into the Tails



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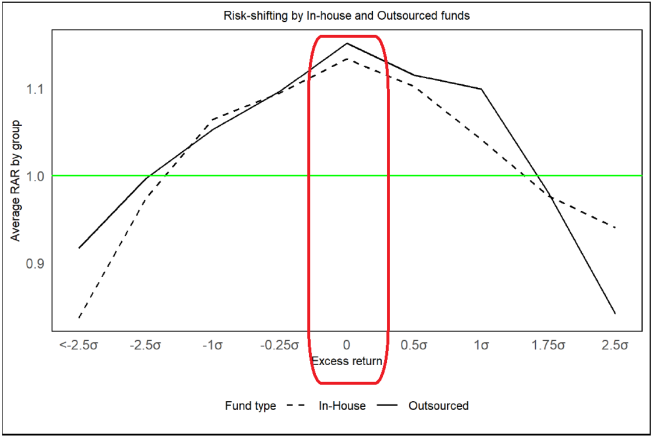

The focus is on performance near the benchmark.

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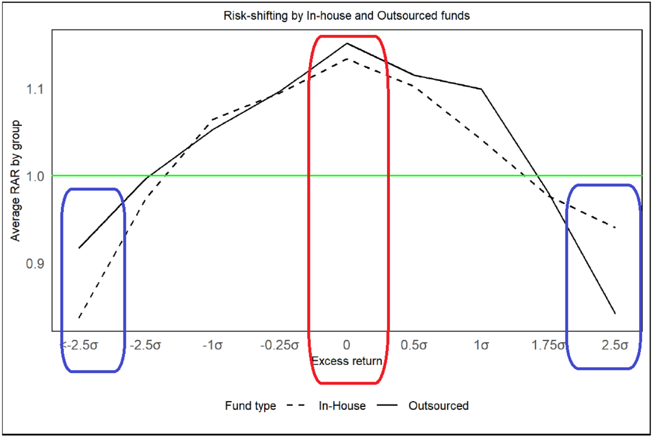

But there appears to be something interesting happening in the tails.

Major Point 3: Package the Mitigators as Practical Fixes

What they show (good!)

- **Co-management** (*peer monitoring/competition*) $\Rightarrow$ lower RAR.
- **Co-location** (*lower oversight frictions*) $\Rightarrow$ lower RAR.
- **Co-branding** (*reputation on the line*) $\Rightarrow$ lower RAR.

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Opportunity: present as *solutions*, not just mechanism checks

- **Reframe**: "*How to outsource safely*" — front-load in the main text.
- **Quantify**: report % reduction in RAR for each mitigator (and *any mitigator*).
- **Bundle**: show an "*adoption score*" (0–3 mitigators) vs. RAR and performance.

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Concrete, doable asks

- **Table:** *RAR and alpha by mitigator status* (None/Any/Each).
- **Figure:** bar chart of % RAR reduction per mitigator.
- **Heterogeneity:** effects stronger where monitoring should matter most (e.g., single-fund advisors).

Major Point 4: Magnitude of the Performance Penalty

What they show (good!)

- Outsourced funds underperform by ≈ 15 bps per quarter.
- Underperformance concentrated in **high-RAR outsourced funds**.
- Once you control for RAR, the "outsourced" dummy mostly fades.

Major Point 4: Magnitude of the Performance Penalty

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Opportunity: emphasize *economic magnitude*

- Annualize: ≈ 60 bps/year $\Rightarrow$ *half an expense ratio*.
- Aggregate: $\text{AUM}_{\text{outsourced, high-RAR}} \times \text{bps} =$ *\$ investor losses*.
- Position as a hidden *outsourcing premium* paid by investors.

Major Point 4: Magnitude of the Performance Penalty

What they show (good!)

- Outsourced funds underperform by $\approx$ 15 bps per quarter.
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Concrete, doable asks

- **Table:** $RAR \times outsourced \Rightarrow alpha$, with annualized numbers.
- Back-of-envelope \$ estimate using average outsourced AUM.

Recap

What I like

- Interesting and relevant question: incentives in outsourced mutual fund management.
- **I am convinced that outsourcing results in high risk-shifting.**

Four major points

1. Streamline paper/theory: focus on retention, simplify (drop) *nexus*, and shorten the paper.
2. Dig into the tails of RAR—left vs. right tails tell different stories.
3. Package the mitigators (co-management, co-location, co-branding) as practical fixes.
4. Emphasize the economic magnitude of the performance penalty.

Overall: a strong and promising paper!.