

The Coming Wave: Where Do Emerging Market Investors Put Their Money?

G. Andrew Karolyi

Cornell University

and

David T. Ng

Cornell University

and

Eswar S. Prasad

Cornell University

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Summary

Emerging market economies are playing an increasingly prominent role in global finance, with outflows of financial capital from these economies rapidly gathering momentum. Our goal in this paper is to characterize comprehensively - to the best of our knowledge for the first time - the global allocation of foreign portfolio equity assets of emerging market investors.

In examining how emerging market investors allocate their stock portfolios, we focus on the foreign bias as our objective is to study foreign portfolio investment patterns among emerging market investors.

Using both country-level and institution-level data, we find that the coming wave of emerging market investors systematically over- or under-weight their holdings in some target countries. These abnormal foreign allocation biases of emerging market investors offer robust support of the information endowment hypothesis. Specifically, past capital and trade flows from a foreign country to the home country create an information endowment (or advantage) that lead home country investments to be overweight that foreign country. At the institutional level, information advantage proxies based on relationships between emerging market institutional investors and the headquarters of their parent companies have strong explanatory power for international portfolio allocations. The results remain robust after controlling for other factors like geographic and other measures of economic proximity, economic and capital market development, market integration, market returns and correlation, and corporate governance. The information advantage effect is stronger for emerging market investors for which external portfolios exhibit a higher degree of concentration.