

The flow-performance relationship in emerging market bond funds

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Summary

We investigate the relationship between net inflow to mutual bond funds that invest in emerging market economies (EMEs) and the past performance of these funds. Our main finding is that EME bond funds display a *convex* flow-performance relationship. In other words, past performance is a significant factor driving fund inflow when the fund return is positive, but its influence vanishes when the return is negative. This convex flow-performance relationship is arguably attributable to practices taken by fund management companies to dampen fund investors' incentives to redeem in reaction to poor performance, bias of media coverage towards outperforming funds, and the relatively high participation costs of EME bond funds. Furthermore, we found that fund performance directly and indirectly affects fund flow. In particular, the performance of a volatile fund is typically less influential on its future fund flow. This can potentially be explained by investors' perception of the volatile return being less informative. We also found that a larger fund would generally record a higher sensitivity in its fund flow in response to a given change of past performance.