

Playing favorites: Conflicts of interest in mutual fund management

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Abstract

We examine the performance of mutual funds whose managers simultaneously manage portfolios with performance-based incentive fees for three account types: mutual funds, hedge funds, and separate accounts. Importantly, our data set is free of selection bias because it is hand-collected from mandatory SEC filings. We find that *only* funds whose managers also manage hedge funds significantly underperform peer mutual funds. Moreover, underperformance begins only after fund managers begin to manage a hedge fund. We find that managerial incentives and opportunities for cross-subsidization explain variation in underperformance across funds, supporting the conflicts of interest hypothesis in the debate on “side-by-side management.”

JEL Classification: G23, G28, G11

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