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Top 10 institutional investors fuel market volatility, study finds

Researchers say concentration of ownership adds to mispricings embedded in shares

The findings are at odds with BlackRock's assertion that the growth of exchange traded funds has contributed positively to the price discovery in stock markets © Bloomberg

Chris Flood 5 HOURS AGO

BlackRock, Vanguard, State Street, Fidelity and Capital Group are driving up equity market volatility and fuelling mispricing in company stocks, according to an analysis that raises fresh questions over the regulatory oversight of the largest asset managers.

Global regulators have wrestled for more than a decade over whether large asset managers should be classified alongside big banks as systemically important financial institutions. Tighter rules would drive up running costs and cut the profits of these businesses.

The 10 largest institutional investors collectively own more than a quarter of the US stock market after quadrupling their holdings since 1980.

Concentration of ownership and the increasing importance of the trading activities of the top investors has pushed up the volatility of stocks held in their portfolios and added to the "noise" or mispricings embedded in shares, according to a study by four finance professors.

Trading strategies and capital flows within large asset management companies are more correlated than similar activities across other smaller fund groups. Smaller fund managers trade against each other, which cancels out their impact. Large institutions tend to trade massively in one direction. This may be explained by the role that centralised functions such as research, risk management and marketing play at large asset managers as well as the influence of the overarching corporate identity that helps to guide decisions by portfolio managers.

"Top institutions trade in larger volumes and have a greater impact on stock prices. The trading activity of large institutions explains their impact on volatility," said Itzhak Ben-David from Ohio State university. Mr Ben-David worked on the study alongside Francesco Franzoni from USI Lugano, and Villanova University's Rabih Moussawi and John Sedunov.

The findings are at odds with BlackRock's assertion that the growth of exchange traded funds has contributed positively to the efficiency of price discovery in stock markets.

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John Sedunov

Vanguard rejected the academic's findings. The world's second largest asset manager said its proprietary research had found "no causal relationship" between the large growth in index tracking fund assets and market volatility.

"The trading volume attributable to the portfolio management activity of index funds in the US is less than 5 per cent. Although index funds have grown, trading activity is minimal," said Vanguard.

After examining regulatory filings between 1980 and 2016, the study concluded that stocks with higher ownership by the 10 biggest institutional investors also registered larger price falls in periods of market turmoil.

"Stocks with higher levels of ownership by large institutions experience significantly lower returns during periods of market turmoil because they engage in massive sales and depress stock prices," said Mr Franzoni.

"Their impact on stock prices is much larger than a collection of small institutions managing the same amount of assets," added Mr Sedunov.

The academics also examined BlackRock's acquisition in 2009 of Barclays Global Investors division, the asset management industry's most important deal over the past decade. They found an increase in volatility in stocks owned by the enlarged group compared with their holdings before the takeover.

Politicians, as well as regulators, are paying closer attention to the importance of big asset managers.

Two Democratic members of the House of Representatives, Jesús García from Illinois and Katie Porter from California, launched a bill in April to address systemic risk in the financial system which called for Congress to "rein in" BlackRock.

"Excessive concentration of stock ownership in the asset management industry may pose a systemic threat," warned Mr Moussawi.