

# Self-Inflated Returns

Discussant: Yiming Ma

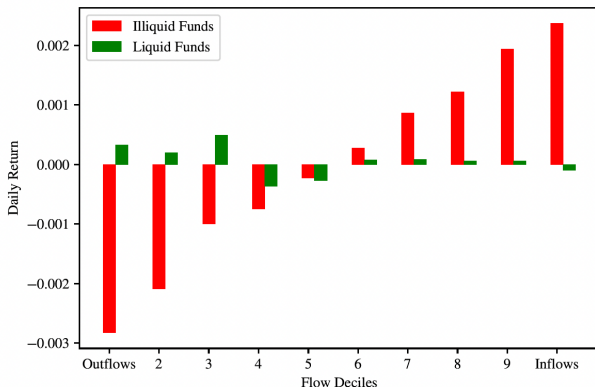
Columbia Business School

AFA Annual Meetings  
January 2026

- Literature on funds' flow-induced selling and price impact
  - More pronounced for illiquid securities
- Literature on funds' flow to performance
  - Performance is proxied by past returns/risk-adjusted returns
- This paper: If fund flows have price impact/affect returns and investors respond to returns, aren't fund flows "self-reinforcing"?

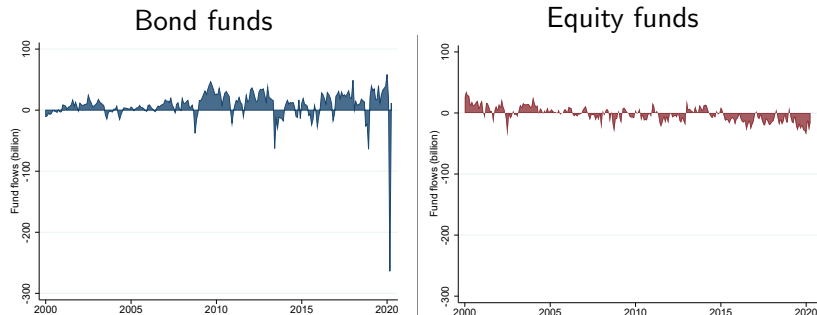
# Key Findings

- When funds with illiquid portfolios grow rapidly without rebalancing into more liquid assets, they generate self-inflated returns via their own price impact.
- Investors chase these returns, triggering a positive feedback loop that inflates both fund size and asset prices



# Contribution

- “Self-reinforcing” flows in the mutual fund literature focused on strategic complementarity and panic runs
  - e.g., Chen, Goldstein, and Jiang 11, Goldstein, Jiang, and Ng 17
  - Intuition: mutual fund NAV does not adjust when outflows trigger costly liquidations of illiquid assets
  - Contributed to large outflows in the Covid-19 crisis



(Ma, Xiao, and Zeng 22)

- This paper is novel along several dimensions
  - ① Focused on inflows rather than outflows
  - ② Does not rely on stale NAV, only illiquidity
    - Self-reinforcing runs occur in mutual funds but not in ETFs: mutual funds have stale NAVs while ETF share prices are forward looking
    - Self-reinforcing inflows in this paper holds across mutual funds and ETFs - more general : Investors response to performance and the price impact of flows do not rely on stale NAVs
  - ③ Unique notion of illiquidity
    - Not the absolute level of portfolio illiquidity
    - Measures how much of the underlying volume a fund buys for a given outflow *relative* to the most liquid portfolio in its universe

# Overall Assessment

- Very interesting + novel results!
- Clever execution
- Important implications for how to think about fund illiquidity, fund returns, and fund growth
- Comments
  - 1 What drives (the choice of) fund illiquidity?
  - 2 What does fund illiquidity imply given under inflows versus outflows?

# 1. What drives (the choice of) fund illiquidity?

- Recall: Fund illiquidity measures how much of the underlying volume a fund buys for a given outflow *relative* to the most liquid portfolio in its universe = portfolio illiquidity \* fund size
- Portfolio illiquidity is a choice of the fund/its investors
- Funds choose to not rebalance into more liquid securities as they grow
- Why is that?

# 1. What drives (the choice of) fund illiquidity?

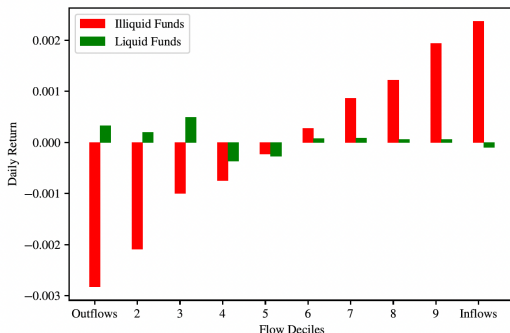
- One possible explanation: illiquidity is correlated with other risk factors
  - Koont, Ma, Pastor, and Zeng 25: bond ETFs include a subset of bonds in their portfolios but these bonds are not the most liquid ones
  - Industry participants: choosing only the most liquid bonds would completely miss the benchmark and load on the wrong risk factors....bond illiquidity is correlated with many things
  - Hence, illiquid portfolios may correlate with other characteristics that load on certain risk factors, which in turn influences their fundamental returns or attractiveness to investors
  - E.g., fixed benchmark indices for passive funds, persistent strategies for active funds

# 1. What drives (the choice of) fund illiquidity?

- Another possible explanation:
  - “... running large, inflated funds – even temporarily – generates high fees and is easier than delivering sustained “fundamental” returns.”
- Could also be possible!
- But the interpretation of the results would be quite different - suggest to explore more
- Also, what happens when there are outflows?

## 2. Inflows versus Outflows

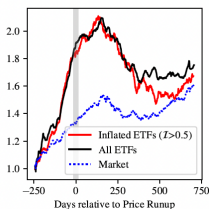
- Current results focus on inflows
- But funds face both inflows or outflows and fund illiquidity has the opposite reinforcing effect for outflows
- Recall mutual fund panic run/Covid-19 literature
- And recall



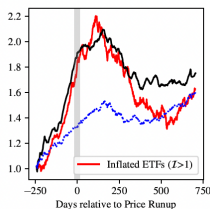
## 2. Inflows versus Outflows

- Self-reinforcing outflows may also contribute to the subsequent “crash” for illiquid funds?

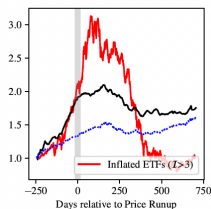
(a) Fund Illiquidity  $\mathcal{I}_{i,t} > 0.5$



(b) Fund Illiquidity  $\mathcal{I}_{i,t} > 1$



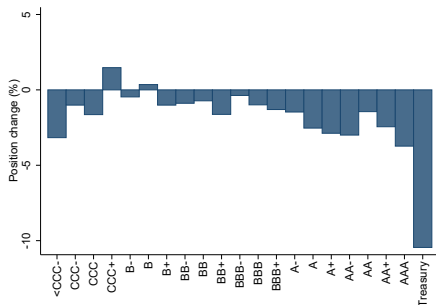
(c) Fund Illiquidity  $\mathcal{I}_{i,t} > 3$



- Maybe: funds with illiquid portfolios generate both self-inflating and self-deflating returns, leading to more volatile returns and flows?

## 2. Inflows versus Outflows

- Outflows may also affect subsequent fund illiquidity depending on which assets funds choose to liquidate
- If more liquid assets are sold first, fund illiquidity may also increase after outflows



(Ma, Xiao, and Zeng 22)

- Suggest to jointly consider the possibility of outflows and inflows for a more general takeaway

# Conclusion

- Very insightful findings on self-inflated returns and self-reinforcing fund inflows!
- Clear contribution to the asset management literature, which has mainly focused on self-reinforcing outflows
- Suggest to think more about the economic interpretation of fund illiquidity → matters for interpretation
- Suggest to jointly consider fund inflows and outflows → more general assessment of fund illiquidity