

The Effects of Misperceived Managerial Skill:

Evidence from Chinese Mutual Funds

Gakushuin University

Yue Cai

Abstract

Many mutual fund investors rely on a fund's past performance when making investment decisions. In this paper, we explore how this phenomenon affects mutual funds' market power and investors' welfare using data from China's mutual fund market. Our findings indicate that chasing past raw returns reduces the sensitivity of investors to expense ratios, thereby increasing the market power of funds with superior past performance. Counterfactual experiments suggest that employing more sophisticated asset pricing models to assess fund managerial skills can enhance investor welfare. For instance, basing investment decisions on performance adjusted by a 4-factor model could increase investor welfare by \$203 to \$615 per year for each investor.