

Discussion of
Structured Beliefs and Fund Investment:
Fundamentals, Policy and Sentiment

By Gao, Xiong, and Yuan

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Discussant: J

Paper summary

- Uses LLM to extract components of fund stock beliefs from “outlooks”
 - Belief = macro + policy + residual
- Key findings
 - Funds trade on all beliefs
 - Policy (residual) beliefs positively (negatively) predict returns

High-level takeaways

- 1) “Weak pass-through” from stated beliefs to demand
 - Retail: Giglio et al., 2021
 - Institutions less so: Dahlquist and Ibert, 2024
 - This paper: institutions do act on their beliefs
- 2) A granular decomposition of beliefs
 - Previous papers treat “equity market expectations” as a single variable
 - Results are novel (I had no prior what to expect)

Comments

1 on empirics

3 on mechanisms

1) Standard errors

	(1)	(2)	(3)	(4)	(5)	(6)
						market_return
Expectation:						
equity_market	0.0585* (1.77)					0.0554 (1.55)
macro		-0.0415** (-1.97)			-0.0124 (-0.47)	
avg_policy			1.043*** (33.96)		1.090*** (32.20)	
equity_resid				-0.248*** (-5.07)	-0.214*** (-4.36)	
Control	Yes	Yes	Yes	Yes	Yes	Yes
Fund FE	Yes	Yes	Yes	Yes	Yes	No
Manager FE	No	No	No	No	No	Yes
N	136169	133132	108751	92292	92292	133929
R-sq	0.009	0.009	0.025	0.018	0.029	0.073

- Standard errors are clustered by fund i
- But the y variable only has variation by t

$$RI_equity_{t+1} = \alpha_i + \beta expectations_{i,t} + \delta X_{i,t} + \varepsilon_{i,t+1}$$

2) Why doesn't macro belief predict returns?

- Two possibilities
 - A) Macro variables don't matter for pricing
 - B) Funds don't successful predict macro (beyond what is priced in)
- I suspect B) is relevant
 - Table 2 shows that policy beliefs indeed predict policies
 - Nothing is shown about whether macro beliefs are successful

3) Residual beliefs: price pressures?

- Can funds trading on sentiment cause negative return predictability?
 - Optimism -> buy -> push up prices -> lowers returns
- Back of the envelope suggest it is **actually large enough**
 - 1 unit higher residual belief -> 1% higher stock/bond allocation
 - If funds represent 5% of market, this means buying 0.05% of market
 - Gabaix-Koijen multiplier of 5: subsequent returns lower by 0.25%
 - Table 5 coefficient $\sim 0.25\%$ -> quantitatively consistent!

4) Where does “residual” belief come from?

- Finding: residual belief correlated with subsequent fund flows
 - Not an extremely strong relationship (t-stat $\cong 2$)
- Paper’s hypothesis: funds strategically *cater* beliefs to align with investor sentiment to attract flows
- Questions:
 - Quantitative: not clear if can generate much variation in fund beliefs
 - Mechanism: do investors read and respond to these “outlooks”?
 - There are simpler stories (e.g. fund sentiment simply correlated w/ investor sentiment)

Summary

- Very interesting paper studying multiple dimensions of fund manager market beliefs
 - Rich interaction with holdings, returns, and flows
- Even more can be done regarding the mechanism