ALUMNI INVESTMENT

We all know that information affects market behaviour.....

Less is known, however, about how information circulates in the market and ultimately influences stock prices. We discovered one method that information spreads and enhances investing success after examining more than 15 years' worth of investment data: through alumni networks.

We looked at a sizable data set...

of mutual fund portfolio managers' trading choices between 1990 and 2006. We contrasted the performance of managers' investments in "connected firms"—companies where at least one senior official attended the same college as the investor—with performance investing in "nonconnected" firms—companies where there were no college connections between the investor and senior ranks

In terms of stock ownership and returns...

our findings show a clear pattern: U.S. mutual fund portfolio managers made more concentrated bets on businesses with whom they had connections through their educational institutions. Additionally, the fund managers outperformed themselves by 7.8% annually on those connected holdings compared to nonconnected ones.

Additionally...

as the strength of the link increases, so do the magnitude of their bets and returns. For example, the effect would be larger if the CEO of the firm and the mutual fund manager were both Wharton MBA Class of 1970 grads than if the manager graduated in 1970 and the executive in 1980.

Investors were precisely ....

selecting the firms inside their alumni network that were the better investment options, not only betting against companies to which they had no college links. By 6.8% annually, connected equities that managers decided to hold beat connected stocks that they decided not to hold. When we looked at sell-side analyst activity, the same result occurred.

Cynics...

will view these findings as proof of an old-boy network or, in the worst case scenario, insider trading. Indeed, once the SEC's Regulation FD (Fair Disclosure) went into force and required widespread rather than selective contact between CEOs and analysts, the alumni network effect for stock analysts in the United States drastically diminished about 2001. (In the UK, there was no equivalent rule, therefore the impact remained unabated.)

Another factor...

is the ability of social networks—human ones, not those on internet platforms—to convey important information. Alumni networks seem to be a particularly successful type of social network. This is partially due to the fact that people frequently self-select into undergraduate and graduate programmed that include social groups with closely related interests to their own, leading to both a higher amount of engagement and connections with a longer lifespan.

College networks...

are extensive and persistent, so fund managers and analysts can get information on other grads both accidentally and on purpose. They are more likely to have already met or share friends. They are aware of what it signifies if someone participated in a certain study programme or club. They could know those who have previously employed them. so on. All of this enables them to more accurately evaluate the capacity of CEOs to manage and run businesses.