Discussion of

Is Hard and Soft Information Substitutable? Evidence from Lockdown

(Jennie Bai and Massimo Massa)

by

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Background

- **Information collection:**
  - Hard (financial statements)
    - Does not require proximity
  - Soft (people on the street/café/factory/golf course/…)
    - May require proximity
- **Voluminous literature:**
  - Local/home bias ~ local information
    - Coval and Moskowitz 1999, 2001
    - Malloy 2005; _____
  - Transmission of soft information **inside** the firm
    - Giroud 2013

Background

- **How to test the hard information channel?**
  - Introduction of electronic access to hard information
    - EDGAR (Bernile et al 2019)
    - Internet in general
- **How to test the soft information channel?**
  - Introduction of proximity access
    - Airline routes (Giroud 2013)
    - High-speed train rail lines (Lin et al 2019)
  - **Removal** of proximity access
    - Electrical outages (Shive 2012)
    - COVID restrictions (**this paper**)

General comments

- Interesting research
  - Strong personal interest
- Well-written paper
- Timely research with interesting results
  - Need to understand the inferences better
- Research question seems to have been well covered
  - Perhaps explore other research questions using this setting?

Comments

1. Informational advantage does not always translate into (excess) holdings

   - Negative information should result in avoidance
     - Mutual funds can't short, but they can underweight

   - Should result in more trading activities – if informational advantage is short-lived
     - Bernile et al 2019 examine "trading" of local stocks
     - Local "holdings" bias has declined over time, but not local "trading" bias ➔ proximity-based informational advantage has declined over time (particularly with EDGAR and internet)
     - Local holdings and local trading bias have low correlation ➔ Firms with high AD may actively trade local stocks
     - Unlike local trading bias, local holdings bias is **not** associated with positive excess returns
     - Funds with high local "holdings" may be inferior (e.g., afflicted by familiarity bias) ➔ affected negatively by COVID

2. All funds increase investment distance

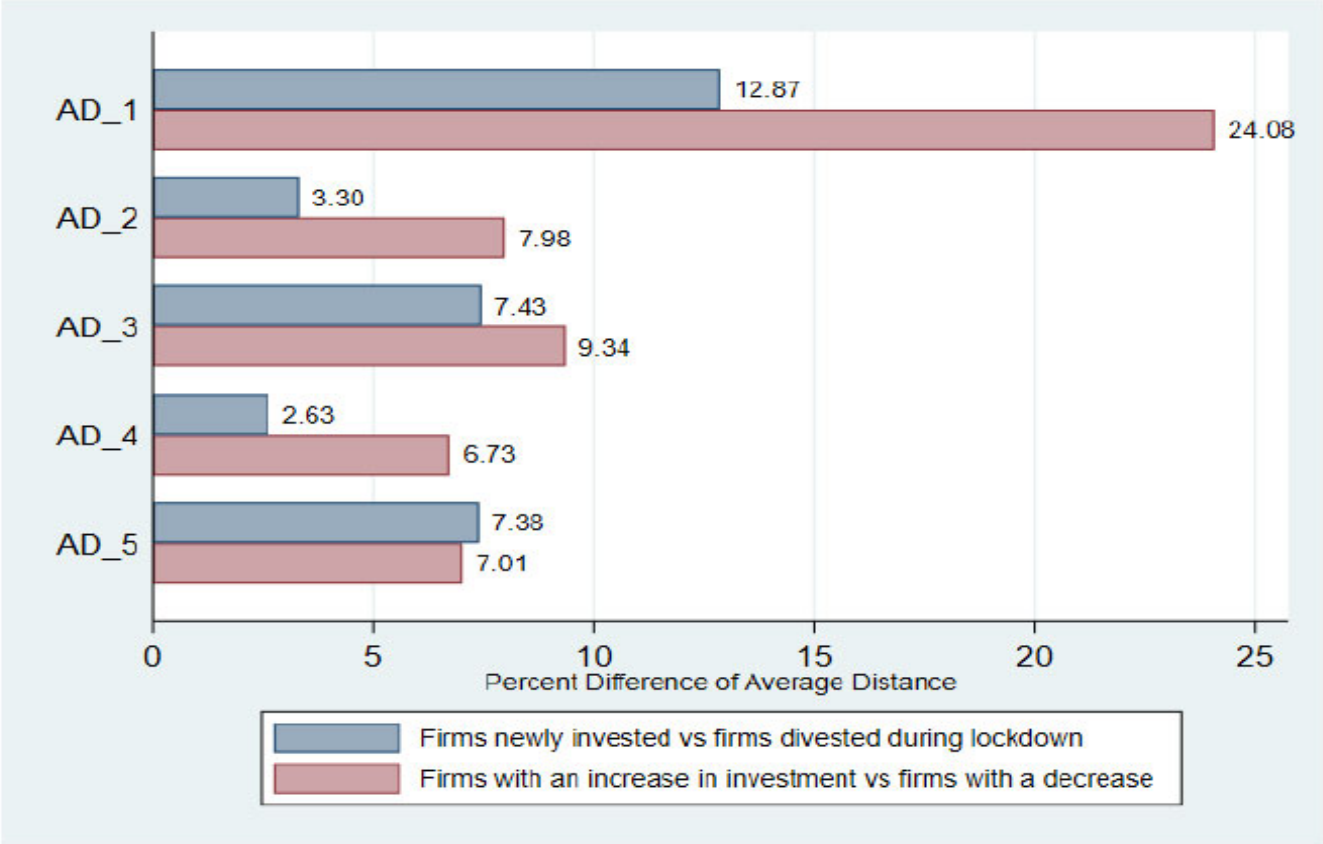

Figure 3: The Average Distance of Firms Invested vs Divested during Lockdown. We sort funds into five quintile portfolios according to their weighted average distance to holding firms as of March 2019: $AD\_1, \cdots, AD\_5$. Then we calculate the percentage difference of the average distance for two groups of firms for each fund within each portfolio: $100\% * \left(\frac{\text{AD of firms newly invested during lockdown}}{\text{AD of firms divested during lockdown}} - 1\right)$ in blue bars, and $100\% * \left(\frac{\text{AD of existing firms with an increase in investment}}{\text{AD of existing firms with a decrease in investment}} - 1\right)$ in pink bars. The average distance is weighted by the excess portfolio weight between the fund and its benchmark on a given stock.

2. All funds increase investment distance

I find this pattern to be VERY interesting

- In contrast to the retrenchment after the GFC (e.g., Forbes and Warnock 2012 JIE)
- What drives this pattern?
  - Active share decreases (T1) – more like index funds?
    - **Reducing idiosyncratic risk seems prudent during high volatility periods!**
    - Perhaps also look at tracking errors?
  - Authors looked at RPI – also drop for all funds? (T3)
    - I don't think the diff-in-diff in T3 would be statistically significant

2. All funds increase investment distance

I find this pattern to be VERY interesting

- Local, soft information production is more costly
  - Should be particularly relevant for some regions (e.g., high trust?)
  - Or some industries (e.g., labor intensive?)

- Need a formal statistical test for Figure 3 (analysis at fund-level, instead of stock-fund level in T2)
  - Need a benchmark window
  - Perhaps compare with the same quarter in 2019:Q2 or 2018:Q2?

3. Do funds lose money on proximate stocks during COVID?

- During lockdown:
  - Do they sell the correct proximate stocks?
  - Do they buy the correct distant stocks?

- More analysis using fund holdings data:
  - Use **return gap** measure (KSZ) to check whether they execute correct trades?
  - Use return **decomposition** using portfolio holdings (e.g., DGTW)?
  - Segregate **local/proximate subportfolio** returns vs. non-local/distant portfolio returns?

4. Do funds trade less during COVID?

- With local information sources being curtailed, do funds trade more or less during the pandemic?
  - Particularly in proximate stocks?

- Shive (2012):
  - (Localized) electrical outages
  - Stock turnover drops by ~5% during an electrical outage in the firm's HQ location

- **Does the (market) information quality of resident firms drop when the area experiences COVID-based movement restrictions?**

5. Magnitudes and Measures

- Current paper focuses on funds that are (very) active
  - Active Share > 0.50
  - What happened with (more) passive funds – AS<0.50?
  - This can be used as Placebo test

- Magnitudes for cross-sectional tests
  - The discussion in the text uses one-standard-deviation ➔ 0.29% higher excess return and 0.76% higher raw return
  - I don't know if we should expect the effect to be linear, so perhaps we want to see (quintile/decile) sorts?
  - Panel B of T5 comes the closest, but why look only at alpha? Reporting raw and benchmarked returns would be useful

5. Magnitudes and Measures

- Benchmark returns seem affected as well
  - The difference between raw and excess returns
  - From numbers above, the benchmark effect (0.47%) is ~**2x** the fund effect (0.29%)
  - Firms with low AD are benchmarked to certain indexes that happened to underperform during COVID
  - Documenting why this is the case would be useful

- Focus on footprint, but what about COVID case counts?
  - Is the reduction in footprint because of restrictions or self-preservation motives?
  - Does this change the quality of local stocks? (Related to comment #3 above)

5. Magnitudes and Measures

- Table 6 seems the most convincing for cross-sectional tests
  - It needs more information: # of observations for each ”pair“?
  - Why not use suffer dummy as main independent var, instead of lockdown and footprint?

- Table 7 is very difficult to interpret
  - The low numbers of observations rendering comparisons across regression models difficult
  - “Golf” has the highest magnitude – it seems significant, but N is low
  - Similarly, “Amusement” seems significant, but N is low

- Look directly at fund size in Table 8
  - Instead of N(mgr) which could reflect reporting decision
  - Larger funds are likely to rely less on proximity info advantage

5. Magnitudes and Measures

- Sub-advisory analysis in Table 9 Panel B does not seem useful
  - Measuring proximity for sub-advised funds (SA=1) seems quite tricky
  - My prior is that sub-advised funds should be more local – sub-advisors rely more on proximity based informational advantage
  - But this may not be captured if the recorded fund location is at the fund-level
  - I may have missed it, but the recorded location is for sub-advisors or the fund company itself?
  - In general, I view the location data as quite **noisy** for sub-advised funds (SA=1)

- My prior: results should be stronger for NON-sub-advised funds (SA=0) because their fund location is not measured with noise
  - Current result is somewhat inconsistent with this prior

General observations

Interesting research

- Interesting and timely results
- Consistent with my prior – declining local bias

Need more work?

- Focusing more on (general) time-series pattern
- Looking at trading (both at the fund level as well as the market level)
- Finding more robust cross-sectional variations
  - What drives the effect on benchmark returns?

Minor note on Figure 1

- Figure 1 needs a formal statistical test
  - Text: "As shown from both panels, the average distance before lockdown is relatively flat and there is no statistically significant change over months."
  - However, looking at the current pattern leads me to think that there is an increasing trend over the last 10 months
  - Can my hypothesis be rejected?

- Displaying a longer time trend (3-5 years?) would be useful
  - My own research (in Bernile et al 2019) indicates that the trend line should be increasing over time

- When is the "event" date?
  - Perhaps the graph should be in event time rather than in calendar time