Do long-term institutional investors contribute to financial stability? – Evidence from equity investment in Hong Kong and international markets

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Summary

This paper assesses whether long-term institutional investors help stabilise or destabilise Hong Kong and international stock markets. We use a novel dataset based on individual funds issued by insurance companies and pension funds worldwide. This allows us to examine each economic region in conjunction with the remaining regions, not in isolation as in bilateral flow-based analysis. Overall, our results indicate that these institutional investors would be counter-cyclical (i.e., they buy past losers and sell past winners) for most stock markets (including Hong Kong) during normal market conditions, which could temper upward and downward movements in asset prices. During adverse market conditions, these investors would become pro-cyclical for some stock markets in advanced economies, which could exacerbate price volatility. This implies that these long-term institutions would have a

destabilising impact on these markets during the market downturns. The pro-cyclicality may reflect that some AEs were the epicentre of several major stock market crashes during the sample period. Moreover, the influence of pro-cyclicality would be reinforced by the LTIIs' herding behaviour.