# Trust and Investment Management: The Effects of Manager Trustworthiness on Hedge Fund Investments*

Ankur Pareek† Roy Zuckerman‡

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**Abstract**

This paper studies the effect of trust or perceived manager trustworthiness on hedge fund investment. Controlling for past-performance, we find that hedge fund managers whose photographs are rated as more trustworthy are able to attract greater fund flows. In addition, we find that more "trustworthy" managers are also more likely to survive. We find no evidence that perceived trustworthiness predicts actual manager skill. In fact, managers who are perceived as more trustworthy perform worse and generate *lower* risk-adjusted returns when compared to those who are perceived as less trustworthy. We attribute this phenomenon to over-investment with "trustworthy" managers caused by an investor bias. Our study joins the growing literature discussing the role of trust in economic outcomes, and suggests that trust could play a major role in investment decisions, even for sophisticated investor sets.

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†**Correspondence Information:** Ankur Pareek, Rutgers Business School, 1 Washington Park, Newark, NJ 07102. Tel. +1-973-353-1646. mailto:ankur.pareek@business.rutgers.edu.

‡**Correspondence Information:** Roy Zuckerman, Rutgers Business School, 1 Washington Park, Newark, NJ 07102. Tel. +1-973-353-1365. mailto:zuckerman@business.rutgers.edu.

# 1 Introduction

Recent studies have identified trust as having an important role in economic transactions. Duarte et al. (2010) show that Prosper.com peer-to-peer borrowers who are perceived as less trustworthy are also less likely to have loan requests filled. Using a similar dataset, Ravina (2008) shows that after controlling for the financial characteristics of borrowers, personal characteristics, such as beauty, affect the likelihood of receiving a loan. Guiso and Sapienza (2008) study the effect of trust on stock market participation. They show that less trusting individuals are less likely to buy stocks and conditional on buying stocks, they buy less. In a recent study, Brown et al. (2011) show that operational risk, constructed using due-diligence reports from a major hedge fund due-diligence firm, predicts subsequent fund failures and performance characteristics.

In this paper, we contribute to this literature. Specifically, we test the effect of trust, or more explicitly, manager trustworthiness, on hedge fund investment. Our underlying hypothesis is that trust may play an important role in the hedge fund industry due to the absence of public disclosure requirements and lack of verifiable information.

We address this question by introducing a new approach to measuring perceived trustworthiness of hedge fund managers[1] Our approach is based on personal characteristics. There are two reasons why personal characteristics, such as appearance, may play a role in perceived trustworthiness of hedge fund managers: First, Social Psychology and Neuroscience literature provides ample evidence that facial appearance is an important determinant of perceived trustworthiness for individuals.[2] Secondly, anecdotal evidence suggests institutions

[1]Even though our measure is a perceived trustworthiness measure, we use the terms "perceived trustworthiness" and "trustworthiness" interchangeably throughout the paper for convenience.

[2]The idea that individuals use facial characteristics to judge trustworthiness of other individuals in social and professional settings has a strong psychological and neurobiological foundation. Winston et al. (2002) conduct an event-related fMRI study to examine the neurobiological basis for perceived trustworthiness based on the facial characteristics of individuals. Todorov et al. (2005) show that the inferences of competence based solely on facial appearances predicted the outcomes of U.S congressional elections better than chance (e.g. 68.8% of the senate races in 2004) and also were linearly related to the margin of victory.

and high net worth individuals use their face-to-face meetings with hedge fund managers as an important criterion for making their initial and subsequent investment decisions[3]

To build our measure of trustworthiness, we begin with collecting publically available photographs of hedge fund managers using Google Images$^{TM}$. The photographs are then rated by a group of unrelated subjects for personal characteristics, such as trustworthiness, age, and attractiveness. Each photograph is rated by 25 individuals through an online survey platform provided by Yale eLab. As part of the survey, we ask the respondents to rate the trustworthiness of the managers on a scale of 1 to 10 based only on their photographs. For each manager, we then calculate an average of the respondents' ratings to construct our measure of manager trustworthiness

Using this measure, we attempt to answer two questions: whether perceived manager trustworthiness has an effect on investors' behavior, and whether this effect is *rational*, i.e. is supported by fundamentals. The latter question is of particular interest. If investors assign excessive weight to perceived trustworthiness, it could potentially lead to over-investment with managers who are perceived as more trustworthy and under-investment with managers who are perceived as less trustworthy. As a result, we may see that managers who are perceived to be more trustworthy, generate, on average, lower risk-adjusted returns compared with managers who are perceived to be less trustworthy.

We measure investor behavior through fund flows. Following the existing literature, we examine fund flows in three separate return terciles (low, middle and high past performance).[4] Consistent with the hypothesis that investors are affected by perceived trustworthiness, we find that hedge fund flows are more sensitive to past performance for fund managers who are perceived to be more trustworthy. Specifically, we find that controlling for assets under management, fund age, and return variance, flows for trustworthy managers with past aver-

[3]For example see "Hedge Fund Marketing: 10 Steps to Gaining More Clients". Available at http://www.finalternatives.com/node/12509.

[4]See Brown et al. (2011) for example.

age performance are more sensitive to past performance than for comparable untrustworthy managers. For example, for a manager with average past performance (about 10% per year), an increase in the mean trust score from 3 to 6 would lead to an additional inflow of 23% in assets under management.

Next, we examine the impact of our trust measure on hedge fund survival probability during our sample period. We attempt to establish whether perceived trust also affects the probability of survival. In a similar manner to flows, we find that the probability of survival for more trustworthy managers is less sensitive to past performance than for untrustworthy managers. In other words, given a certain performance level, a manager who is perceived to be more trustworthy is also more likely to survive. For instance, for a manager who has had poor returns during the past year (two standard deviations below the mean) a one standard deviation increase in our trust measure from its mean value decreases the probability of liquidation by up to 27%. Consistent with the premise that negative returns drive fund liquidations, we find that the effect is confined to the poor (negative) return space, and we do not see the same effect for positive returns. i.e. a manager with average returns during the past year is not more likely to liquidate his fund than a manager with above average returns.

We find no support for the hypothesis that perceived trustworthiness positively predicts underlying fundamentals, such as the manager's ability to generate abnormal returns. In fact, we find that managers who are perceived to be more trustworthy generate, on average, lower risk-adjusted returns, of up to 50 basis points per month, compared with managers who are perceived to be less trustworthy. We also find that funds managed by more trustworthy managers tend to be more persistent losers. A one standard deviation increase in our trust measure (from the mean), leads to an approximately 3% increase in the odds of being a persistent loser.

In addition, we find that more trustworthy managers are able to secure more favorable

incentives. A one standard deviation increase in our trust measure from its mean value decreases the odds of having high water marks by 7%. We find no evidence that trustworthy managers are less likely to smooth returns.

Recent studies have related personal characteristics, or appearance, to investment behavior. While these studies have focused mostly on individual investors, who arguably, are less sophisticated and more prone to behavioral mistakes, this paper shows that trustworthiness, as elicited by personal characteristics, can play a major role even with a more sophisticated investor set, such as hedge fund investors.

The results in this paper also have broader implications for the *rationality* of investor preferences. While the literature on trust is inconclusive regarding the question whether trait inferences, such as perceived trustworthiness, are correlated with underlying fundamentals, such as the managers' ability to generate returns, we find no support for this hypothesis in our sample. Our findings imply that the true manager ability is uncorrelated with perceived trustworthiness, suggesting that investors overweight the value of personal characteristics.

The rest of the paper is organized as follows: Section 2 provides a description of our measures and the various datasets used in the paper. Section 3 examines the effect of trust on the hedge fund flows. Section 4 presents fund survival results. Section 5 discusses the link between perceived trust and hedge fund returns, while section 6 shows results for robustness tests. Section 7 concludes.

# 2 Data and Methodology

## 2.1 Data Description

We obtain fund characteristics and performance data for hedge funds from Lipper/TASS. Our analysis spans from 2000 to 2009 and includes both live and graveyard funds. We

collect publically available photographs of hedge fund managers from the World Wide Web using Google Images$^{TM}$. Our sample of photographs consists of 202 hedge fund managers corresponding to 164 hedge fund management firms. We merge this sample of fund managers with TASS hedge funds and obtain a final sample of 574 funds.

Photographs of hedge fund managers are rated by a group of unrelated subjects for personal characteristics, such as trustworthiness, age and attractiveness. We standardize the photographs by converting them into black and white and resizing them to a standard resolution. The photographs chosen are professional photographs of hedge fund managers in business attire and most photographs are taken on plain background, rendering them similar to each other in every aspect other than the facial appearance of managers. Each photograph is rated by 25 different individuals through an online survey platform provided by Yale eLab. Online participants complete the survey form attached in Appendix A, evaluating the perceived trustworthiness of the hedge fund managers (based solely on photographs) and are compensated through a gift certificate lottery. In question 1 of the survey, we ask participants to rate the trustworthiness of one hedge fund manager from our sample on a scale of 1 to 10. We calculate the mean of the responses to this question across all participants who evaluated a given photograph to construct our primary measure of manager trustworthiness. Similarly, we take averages of responses to questions 4 and 5 to generate measures of manager attractiveness ($Attract\_Mean$) and manager age ($Age\_Mean$).

Panel A of Table I reports summary statistics for various characteristics of funds and managers in our sample. We also include summary statistics for all TASS funds for comparison. Our sample consists of 587 funds, out of which 397 were live at the end of 2009 and rest were defunct. The average fund in our sample is slightly larger and older than the average fund in the hedge fund universe. The average size or assets under management for the funds in our sample is \$154 million compared to \$112 million for the entire dataset. Manager trustworthiness ($Mean\_Trust$) for our sample varies between 3.8 and 6.9, with a

mean of 5.6. Panel B of Table I reports the strategy distribution for the funds in our sample. The vast majority of the funds in our sample follow equity-based strategy with 46% of the sample consisting of long-short equity hedge funds. Panel C shows the rank correlation matrix between the different variables used in the study.

## 2.2 Performance Measurement

We use two measures to estimate the average performance of a hedge fund over its lifetime. The first performance measure is calculated as the fund-level time-series regression intercept, or alpha from the Fung and Hsieh (2004) seven-factor model. The seven factors included are S&P: Standard & Poors 500 stock return, SC-LC: Wilshire 1750 Small Cap minus Wilshire 750 Large Cap return, 10Y: month end-to-month end change in the Federal Reserve's ten year constant maturity yield, CredSpr: month end-to-month end change in the difference between Moody's Baa yield and the Federal Reserve's ten year constant maturity yield, BdOpt: return of a portfolio of lookback straddles on bond futures, FXOpt: return of a portfolio of lookback straddles on currency futures, ComOpt: return of a portfolio of lookback straddles on commodity futures.

Alpha is calculated as the intercept from the following model:

$$\begin{aligned} r_{i,t} - r_f &= \alpha_i + \beta_{1,i} S\&P_t + \beta_{2,i}(SC - LC)_t + \beta_{3,i} 10Y_t + \beta_{4,i} CredSpr_t \\ &\quad + \beta_{5,i} BdOpt_t + \beta_{6,i} FxOpt_t + \beta_{7,i} ComOpt_t + \varepsilon_{f,t} \end{aligned} \tag{1}$$

We calculate the fund alpha by estimating regression model (1) using the entire available history of monthly returns for each fund. We also present a related performance measure (Appraisal Ratio), defined as the intercept from model (1) divided by the standard deviation of residuals obtained from the regression model.

### 2.3 Flow-Performance Relationship

The fund flow performance function is estimated using a piecewise linear relationship between current fund flows and past returns. Similar to Ding et al. (2009), we apply a modification of the methodology used by Sirri and Tufano (1998) in the study of the mutual fund flow-performance relationship. First, we calculate a fractional rank ($Frank_{i,t}$) from 0 to 1 for each fund $i$, based on returns for all the funds in the sample during year $t$. Next, we define three performance terciles as follows:

$$\begin{aligned} Low_{i,t} &= Min(\tfrac{1}{3}, Frank_{i,t}) \\ Mid_{i,t} &= Min(\tfrac{1}{3}, Frank_{i,t} - Low_{i,t}) \\ High_{i,t} &= Min(\tfrac{1}{3}, Frank_{i,t} - Mid_{i,t} - Low_{i,t}) \end{aligned} \tag{2}$$

We measure flows into each fund i as the percentage change of net assets under management for fund $i$ between the beginning and the end of year $t$, net of investment returns:

$$Flow_{i,t} = \frac{AUM_{i,t} - AUM_{i,t-1}(1 + R_{i,t})}{AUM_{i,t-1}} \tag{3}$$

# 3 Flows and Trust

In this section, we examine the effect of our trust measure on hedge fund flows during our sample period. We hypothesize that if investors care about perceived trustworthiness they would invest more with those who they see as more trustworthy and less with those who they see as less trustworthy. This would be manifested in the data through greater fund flows to trustworthy managers and smaller flows to untrustworthy managers conditional on performance levels.

Previous research has linked trust to investment behavior. Duarte et al. (2010) show that peer-to-peer borrowers on Prosper.com who are perceived as less trustworthy are also less likely to have loan requests filled. Graham et al. (2010) conduct a study of 2,000 CEO

photographs and conclude that CEOs who are perceived by subjects as more competent are also more highly compensated. Guiso and Sapienza (2008) study the effect of trust on stock market participation. They show that less trusting individuals are less likely to buy stocks and conditional on buying stock, they buy less.

To assess the effect of perceived trustworthiness on fund flows, we regress fund flows on past fund returns ($Ret(t-1)$), our measure of perceived trustworthiness ($Mean\_Trust$), and a series of controls.

We eliminate from our sample funds with missing returns or AUM data and funds during liquidation years. Consistent with Brown et al. (2011), we group returns into terciles ($High/Medium/Low$). Our controls include the standard deviation of returns ($StdRet$), log of assets under management ($LogAUM$), fund age ($Fund\_Age$), lagged fund flows ($Lag\_Flows$) and the median flow into the fund style ($Median\_Styleflow$). We also evaluate the interaction terms between high, medium and low returns, our trust measure and fund age.

## 3.1 Flow Results

Table II presents results for the flows regression. The first three specifications include Fama-Macbeth estimates for all funds in our sample (live and graveyard funds), while the latter two include live funds only. For robustness, we also present estimates from a pooled panel in column 4. As evident from specification 2, the interaction term between the medium return tercile and our trust measure is positive and significant (0.484). That is, flows for trustworthy managers with past average performance are more sensitive to performance than flows for untrustworthy managers with similar returns. Consistent with the literature on mutual and hedge fund flows, we do not find a significant coefficient for the flow-performance relationship in the lower return tercile.[5] We also do not find a link between trust and flows for the high

[5]For example, see Sirri and Tufano (1998), Ding et al. (2009), and Brown et al. (2011).

return tercile.[6]

The economic magnitude of this result is large. To illustrate, suppose that we move from a trustworthiness score of 3/10 to a trustworthiness score of 6/10. Such a move for a manager with average past returns (fractional rank of 0.16 corresponding to a raw return of 10%) would increase flows to the fund by 23.2% (3 X 0.484 X 0.16). A more extreme move from a trustworthiness score of 3/10 to a trustworthiness score of 8/10 would increase flows to the fund by 38.7%. That is, holding everything constant, instead of generating $1 in flows, the same manager would attract $1.39 dollars in flows.

The results imply that investors are more likely to invest with trustworthy managers with average past performance, than untrustworthy managers with similar past performance. This observation is consistent with the hypothesis that trust is important to investors and that perceived trustworthiness affects investment decisions.

The results remain consistent when adding controls for fund age (specification 3) and in the pooled panel (specification 4). Specifications 5-6, which include live funds only yield similar or even stronger results.

# 4 Fund Survival

In this section, we examine the effect of our trust measure on hedge fund survival probability during the sample period. Following the fund flows results, we attempt to establish whether more (less) trustworthy managers also have a lower (higher) probability of survival. This test tries to further establish the link between trust and investor behavior and serves as a complement to the flows results. Chan et al. (2005) show that (negative) year to date flows are a significant driver of fund liquidation. However, as mentioned in the previous section, flows during liquidation years are omitted from our flows regression, raising the need for an

[6] A possible explanation for this is that very high returns are a sufficiently strong signal to override the effect of trust.

additional test.

We capture the effect of extreme negative flows using a probit model in which the dependent variable is the probability of liquidation, while the independent variables include one year lag returns ($Ret(t-1)$), our trust measure ($Mean\_Trust$), the interaction term between our trust measure and lag returns ($Mean\_Trust * Ret(t-1)$) and controls.

Our controls consist of the standard deviation of lag returns ($StdRet(t-1)$), log of assets under management ($LogAUM$(t-1)), fund flows ($Flow(t-1)$), and fund age ($Fund\_Age(t-1)$).

## 4.1 Survival Results

Table III presents results for the survival regression. We present the estimates separately for funds with negative abnormal returns during the current year (specifications 4-5) and with positive abnormal returns (specifications 6-7). Abnormal return for a fund is calculated by subtracting the mean annual return for the funds in the same investment style or strategy group from the annual return of the same fund in the same year. The first three specifications represent the entire sample. In a similar manner to flows, the interaction term between last year's abnormal return and our trust measure (specifications 4-5) is positive and significant, implying that the probability of survival for more trustworthy managers is less sensitive to past performance than for untrustworthy managers. In other words, given a certain performance level, a manager who is perceived to be more trustworthy is also more likely to survive. Consistent with the premise that negative returns lead to fund liquidations, results only hold for funds with negative abnormal returns (specifications 4-5). We do not find this effect for funds with positive returns.

Controlling for low past performance, flows, standard deviation of returns, assets under management, and fund age, we find that a one standard deviation increase in our trust

measure, decreases the fund's liquidation probability from 3.72% to 2.71%. To illustrate, suppose a manager produces an abnormal return of -31% during a certain year (two standard deviations below the mean). A one standard deviation move in our trust measure would lead to a 27% decrease in the probability of liquidation during the following year.

Table III results complement the flows results given in Table II and support the notion that investor behavior is affected by trust. While Table II results show us that managers who are perceived to be more trustworthy are able to attract more flows, survival results, presented in Table III, show us that trustworthy managers are also more likely to survive. To the extent that fund survival is determined by investor behavior, these results provide additional evidence that investors react to perceived trustworthiness of managers.

# 5 Hedge Fund Returns

In this section, we examine the effect of our trust measure on hedge fund returns during the sample period. We attempt to answer the question whether investment decisions based upon perceived manager trustworthiness are *rational*, i.e. are correlated with actual manager skill. As evident from the flows and survival results, managers who are perceived as more trustworthy attract greater fund flows and have a higher probability of survival. However, the question remains whether managers who are perceived as more trustworthy actually perform better. If indeed perceived trustworthiness is correlated with manager skill, investors may be rightfully rewarding more trustworthy managers with greater flows. In this case, we would expect to see no difference between the risk-adjusted returns for trustworthy and untrustworthy managers. However, if perceived trustworthiness is uncorrelated with manager skill, our flows results could imply over-investment with managers who are seen as more trustworthy and under-investment with managers who are perceived as less trustworthy. As a result, we may see that managers who are perceived to be more trustworthy, generate, on

average, *lower* risk-adjusted returns compared with managers who are perceived to be less trustworthy.

The existing literature is split on whether perceived traits are correlated with underlying fundamentals. Duarte et al. (2010) show perceived trustworthiness predicts peer-to-peer borrower defaults on Propser.com, beyond known measures, such as credit rating and disposable assets. However, others, such as Graham et al. (2010), do not find any correlation between perceived CEO competence and actual performance. Ravina (2008) also does not find that beauty predicts actual defaults rates.

To assess the effect of perceived trustworthiness on fund returns, we regress Fung and Hsieh (2004) seven factor alphas ($Alpha\_7Factor$) on perceived trustworthiness ($Mean\_Trust$), and a series of controls. For robustness, we also try other specifications using appraisal ratio ($Appraisal\_Ratio$) as the dependent variable.

Our controls consist of the standard deviation of returns ($StdRet$), log of assets under management ($LogAUM$), fund age ($Fund\_Age$). For robustness purposes, we also estimate the regression by splitting the sample into binary trustworthy and untrustworthy ranks ($Trust\_Rank$), where the trustworthy managers are assigned the rank 1 and untrustworthy managers are assigned the rank 0.

## 5.1 Returns Results

Table IV presents results for the returns regression. The first five specifications include estimates for all funds in our sample (live and graveyard funds), while the latter three include live funds only. As evident from specification 1, $Mean\_Trust$ is negative (-0.0017) and significant at the 5% level. That is, managers who are perceived as more trustworthy, generate, on average, *lower* risk adjusted returns than those who are perceived as less trustworthy. When controlling for manager age (specifications 2-3), results remain qualitatively similar,

though $Mean\_Trust$ loses some power in specification 2, while $Trust\_Rank$ (specification 3) remains highly significant.

The results are also economically significant. For example, a move in our trust measure from 4/10 to 5/10 decreases seven factor alphas by 17 basis points per month. A bigger move in our trust measure, from 3/10 to 6/10 would decrease expected seven factor Alphas by 51 basis points per month.

The results provide support to the hypothesis that investors assign excessive weight to perceived trustworthiness. Results from Tables II and III show us that investors decisions are affected by perceived trustworthiness. Table IV results add to these and show that this behavior is not justified by actual fund performance. That is, investors are over-investing with trustworthy managers, which, in turn, produce lower risk adjusted returns.

# 6 Robustness

## 6.1 Performance Persistence

Following the return results, we examine whether perceived trust is related to performance persistence. Results in Tables II-IV demonstrate that more trustworthy managers attract more flows, while having lower risk adjusted returns. We conclude that this behavior by investors is *irrational* in the sense that investors assign excessive weight to perceived manager trustworthiness, resulting in misallocation of capital and lower risk-adjusted returns. However, an alternative hypothesis could be that investors are compensated for lower risk-adjusted returns through a different channel. Such a channel could be (positive) performance persistence. That is, that more trustworthy managers have greater (positive) performance persistence which compensates investors for poorer overall performance. This hypothesis has some support in the literature. Agarwal et al. (2004) show that hedge fund investors value

performance persistence and that managers with more persistent returns are able to attract greater flows when compared to less persistent managers.

To measure hedge fund performance persistence, we follow Brown et al. (2011) and Agarwal et al. (2004) and estimate a probit model in which the dependent variable is the probability of lower (higher) than average performance in year $t$ conditional on lower (higher) than average performance in year *t-1*. We define lower (higher) than average performance relative to the mean (raw) style return during the reference year. Our independent variables include year to date returns ($Ret(t)$), our trust measure ($Mean\_Trust$) and controls in the form of standard deviation of returns ($StdRet$), log of assets under management ($LogAUM$), and fund age ($Fund\_Age$).

### 6.1.1 Persistence Results

Table V presents results for the persistence probit regression. The first four specifications include estimates where the dependent variable is loss (below average performance) conditional on loss in the previous year, while in the latter two, the dependent variable is win (above average performance) conditional on win in the previous year. $Mean\_Trust$ is positive and significant for specifications 1 and 3, implying that more trustworthy managers are also more likely to have consecutive losing years. Results remain qualitatively consistent when adding a control for manager age (specification 2), however, when adding the full set of controls (specification 4), $Mean\_Trust$ becomes insignificant, and the effect is subsumed by manager age. When looking at persistent winners (specifications 4 and 5), $Mean\_Trust$ is insignificant, providing no evidence of a link between persistent winners and perceived trust.

The results in Table V show no evidence that more trustworthy managers generate more positive persistent performance. In fact, results show the opposite effect. Managers perceived as more trustworthy are actually more likely to be persistent losers. Holding everything else

constant, a one standard deviation increase in our trust measure, increases the probability of having consecutive loss years from 49% to 52.3% in specification 1 and from 49% to 51.6% in specification 2. Thse results is statistically significant at the 5% and 10% levels.

If one could hypothesize that investors who invest with more trustworthy managers benefit from more positive persistent performance, Table V results provide no support for this hypothesis.

## 6.2 Performance Smoothing

Another alternative hypothesis could be that managers who are perceived as less trustworthy are indeed less trustworthy and are more inclined to engage in unscrupulous behavior. We test this hypothesis by looking at performance smoothing. Several studies have shown that self-reported, monthly, hedge fund returns often exhibit substantial, "anomalous", positive serial correlation.[7] Getmansky et al. (2004) attribute this to illiquid assets held in funds' portfolios or to intentional misreporting. If more untrustworthy managers engage more in return smoothing, and investors care about smoothing, perhaps the under-investment shown in Tables II-IV may be justified.

To test for return smoothing, we follow Getmansky et al. (2004) and Cassar and Gerakos (2011). Our measures for return smoothing include the first order serial correlation in reported monthly returns ($\hat{\rho_1}$), the smoothed moving average with two lags ($\hat{\theta_0}$) and the Herfindahl Index measure of the concentration for $\hat{\theta_k}$ weights ($\hat{\xi}$). We regress all three measures on our trust measure ($Mean\_Trust$), controlling for assets under management ($LogAUM$), and fund age ($Fund\_Age$).

[7]For example, see Getmansky et al. (2004) and Bollen and Veronika (2008), Bollen and Pool (2009), Cassar and Gerakos (2011) and Agarwal et al. (2011).

### 6.2.1 Smoothing Results

Table VI presents results for the smoothing regression. As evident from the table, $Mean\_Trust$ is insignificant in all three specifications. That is, there is no evidence that managers who are more trustworthy are also less likely to smooth earnings. This result provides no support to the hypothesis that managers perceived as more trustworthy are less likely to engage in untrustworthy behavior.

## 6.3 Incentives

Having shown that conditional on past performance, trustworthy managers are able to attract greater flows and have a higher probability of survival, we next examine whether trustworthy managers are also able to negotiate better incentive contracts. The results are presented in Table VII. In columns 1 and 2 we examine the effect of manager trustworthiness on the magnitude of incentive and management fees. The coefficient corresponding to $Mean\_Trust$ is insignificant which shows that trustworthy managers don't receive higher fees compared to less trustworthy managers. Goetzmann et al. (2003) show that high-water mark provisions in the hedge contracts limit the value of the incentive fees. Therefore, hedge fund managers have an incentive to negotiate an incentive contract without the high water mark provision. From Table I, 78% of the funds in our sample have the high water mark provision in their incentive contract. In column 3 of Table VII, we estimate a probit regression with the probability of having a high water mark in the fee contract as the dependent variable and include manager trustworthiness measure ($Mean\_Trust$) and other fund characteristics as independent variables. The coefficient corresponding to $Mean\_Trust$ is negative and highly significant. For example, one standard deviation increase in $Mean\_Trust$ from the mean leads to the decrease in probability of the inclusion of high-water mark from 88% to 81%. This shows that although, trustworthy managers are not able to negotiate a higher fees but

have a lower probability of inclusion of high water mark provision in their compensation contracts.

In specifications 4-6, we find that manager trustworthiness has no effect on the probability of partner investment, lockup period and restriction period (calculated as the sum of redemption notice and payout period).

# 7 Conclusion

Recent studies in social sciences have identified trust as having a large impact on economic and social outcomes. The impact of trust ranges from stock market investment and peer-to-peer lending to the probability of winning congressional elections.

We investigate the effect of trust on hedge fund investment. Using a photograph based proxy for perceived trustworthiness, we find that trust plays an important role in hedge fund investment.

Hedge fund Managers, with average past performance, whose photographs are rated by participants as more trustworthy are able to attract greater flows than similar managers who were rated at less trustworthy. In addition, we find that controlling for performance and other fund characteristics, managers rated as more trustworthy are also more likely to survive when compared with managers who were rated as less trustworthy.

We further show that manager skill in not captured by perceived trustworthiness. In fact, those who are perceived as more trustworthy actually perform worse and generate *lower* risk adjusted return than managers who were rated as less trustworthy. We attribute this finding an investor bias which causes over-investment with "trustworthy" managers and under-investment with "untrustworthy" managers.

Finally, we attempt to explain the investor bias through performance persistence and smoothing. However, we are unable to find any evidence that more "trustworthy" mangers

are able to generate more positive persistent performance or are less likely to smooth returns. In sum, the alternative explanations tested by us do not provide any *rational* insight to support the implied preference by investors towards more "trustworthy" managers.

Our study joins the growing literature discussing the role of trust in economic outcomes, and suggests that trust could play a major role in investment decisions, even for sophisticated investor sets.

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# Appendix A: Trust Survey

Survey Questions:

1. How would you rate the trustworthiness of the person in the photograph?
   *1 (Least Trustworthy) 2 3 4 5 6 7 8 9 10 (Most Trustworthy)*

2. If you were an investor and you consider making an investment of $1000 with an investment advisor. How likely were you to make such an investment with the person in the photograph, given the opportunity?
   *Very Unlikely Unlikely Somewhat Unlikely Undecided Somewhat Likely Likely Very Likely*

3. How likely is the person in the photograph to manage investments in a trustworthy manner?
   *Very Unlikely Unlikely Somewhat Unlikely Undecided Somewhat Likely Likely Very Likely*

4. Rate the attractiveness of this person in the photograph.
   *1 (Least attractive) 2 3 4 5 6 7 8 9 10 (Most Attractive)*

5. Based on the photograph, please select the most likely age range for the person in the photograph.
   *21-30 31-40 41-50 51-60 61-70 Over 70*

6. Generally speaking, would you say that most people can be trusted or that you can't be too careful in dealing with people?
   *Most people can be trusted You can't be too careful (i.e. you have to be very careful) Don't Know*

7. Suppose that while walking on Michigan Avenue in Chicago and you lose your wallet with 1,000 dollars inside. A random person that you do not know finds it. He or she does not know you, but he or she is aware that the money belongs to you and knows your name and address. He or she can keep the money without incurring in any punishment. According to you, how likely is it that he or she will return the money to you?
   *Very Unlikely Unlikely Somewhat Unlikely Undecided Somewhat Likely Likely Very Likely*

In this section we ask you to answer a few general demographics questions. This data will be kept anonymously and used for statistical analysis purposes ONLY.

1. What is your age group?
   *21-30 31-40 41-50 51-60 61-70 Over 70*

2. What is your gender?
   *Female Male*

3. What is your racial-ethnic background? (select one)
   *African American*
   *Asian*
   *Hispanic/Latino*
   *White*
   *Other*

4. Which state do you live in?

5. Does any member of your household participate in the stock market?
   *Yes No*

6. What is the highest degree or level of education that you have completed? (select one)
   *No college*
   *Some college, no degree*
   *Associate's degree (for example: AA, AS)*
   *Bachelor's degree*
   *Master's degree*
   *Professional degree (for example: MD, DDS, LLB, JD)*
   *Doctorate degree (for example: PhD., EdD.)*

7. What was your total HOUSEHOLD income in the past 12 months (select one)
   *less than $30,000*
   *$30,000 to $49,999*
   *$49,999 to $99,999*
   *$100,000 to $149,999*
   *$150,000 to $199,999*
   *Over $200,000*

Table I

# Summary Statistics - Event Firms

Panel A shows the summary statistics of various fund characteristics for the funds included in the sample and for the entire hedge fund universe. *Fund_Age* is the age of the fund in years. *AUM* is the last reported assets under management of the fund. Alpha is estimated from the fund-level time-series regression of excess returns on the seven factors of Fung and Hsieh (2004). *Appraisal_Ratio* is the appraisal ratio of the fund measured as a ratio of Alpha and standard deviation of the residuals obtained from the fund-level 7-factor regression used to estimate Alpha. *Alpha_Strategy* for a fund is estimated by averaging the monthly differences between the fund return and median return of the funds following the same strategy over the life of the fund. *Mean_Trust* is a measure of manager trustworthiness estimated by averaging the participants' responses to Question 1 of the trust survey shown in Appendix A. *Manager_Age* is measured as the average of the mean of the responses to Question 4 of the survey. *StdRet* is the standard deviation of monthly returns estimated over the entire history of the fund. Panel B presents the distribution of the funds by their reported strategies.

Panel A: Summary Statistics

| **Sample** | N | Mean | Stdev | Min | Median | Max |
|---|---|---|---|---|---|---|
| *Fund_Age*(*Years*) | 587 | 8.79 | 4.93 | 1.17 | 7.83 | 32.08 |
| *AUM*(*millions*) | 587 | 150.8 | 373.8 | 0.00 | 35.1 | 3601.6 |
| *Mean_Trust* | 587 | 5.59 | 0.53 | 3.83 | 5.62 | 6.94 |
| *Median_Trust* | 587 | 5.58 | 0.59 | 4.00 | 5.50 | 7.00 |
| *Alpha*(% per month) | 587 | 0.62 | 0.95 | -4.49 | 0.56 | 6.19 |
| *Appraisal_Ratio* | 587 | 0.21 | 0.42 | -2.60 | 0.19 | 3.24 |
| *StdRet* (%) | 587 | 4.09 | 2.59 | 0.64 | 3.40 | 19.55 |
| *Manager_age* | 587 | 3.03 | 0.70 | 1.31 | 2.91 | 5.00 |
| *Flows* | 2193 | 0.21 | 0.91 | -1.11 | 0.00 | 8.38 |
| *Incentive_Fee* (%) | 354 | 18.71 | 4.73 | 0.00 | 20.00 | 50.00 |
| *Management_Fee* (%) | 354 | 1.38 | 0.48 | 0.00 | 1.50 | 3.00 |
| High Watermark | 354 | 0.78 | 0.42 | 0.00 | 1.00 | 1.00 |
| Partner Capital | 354 | 0.38 | 0.49 | 0.00 | 0.00 | 1.00 |
| Restriction Period (months) | 354 | 67.53 | 35.57 | 0.00 | 60.00 | 270.00 |
| Lockup Period (months) | 354 | 6.12 | 7.93 | 0.00 | 0.00 | 36.00 |

| **Entire Hedge Fund Universe** | N | Mean | Stdev | Min | Median | Max |
|---|---|---|---|---|---|---|
| *Fund_Age*(*Years*) | 6893 | 5.85 | 3.91 | 0.92 | 4.75 | 33.08 |
| *AUM*(*millions*) | 6893 | 111.9 | 445.1 | 0.1 | 18.1 | 13000.0 |
| *Alpha*(% per month) | 6893 | 0.34 | 1.00 | -4.56 | 0.28 | 6.85 |
| *Appraisal_Ratio* | 6893 | 0.14 | 0.50 | -7.47 | 0.12 | 9.31 |
| *StdRet* (%) | 6893 | 3.77 | 3.15 | 0.04 | 2.81 | 33.95 |
| *Flows* | 25653 | 0.21 | 0.90 | -1.77 | 0.00 | 15.34 |

| Panel B: Fund Strategies | | |
|---|---|---|
| **HF Strategy** | Number of Funds | % |
| *Convertible_Arbitrage* | 25 | 4 |
| *Dedicated_Short_Bias* | 5 | 1 |
| *Emerging_Markets* | 63 | 11 |
| *Equity_Market_Neutral* | 51 | 9 |
| *Event_Driven* | 84 | 14 |
| *Fixed_Income_Arbitrage* | 14 | 2 |
| *Fund_of_Funds* | 16 | 3 |
| *Global_Macro* | 6 | 1 |
| *Long_Short_Equity* | 266 | 45 |
| *Managed_Futures* | 9 | 2 |
| *Other* | 42 | 7 |
| Missing | 6 | 1 |
| | | |
| Live | 397 | 68 |
| Dead | 190 | 32 |

| Panel C: Rank Correlation Matrix | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | *Mean_Trust* | *Median_Trust* | *Fund_Age* | Manager_Age | AUM | Alpha_7factor | Appraisal_Ratio | *StdRet* |
| *Mean_Trust* | 1.00 | | | | | | | |
| *Median_Trust* | 0.85 | 1.00 | | | | | | |
| *Fund_Age* | 0.19 | 0.16 | 1.00 | | | | | |
| *Manager_Age* | 0.27 | 0.24 | 0.39 | 1.00 | | | | |
| *AUM* | 0.07 | 0.02 | 0.17 | -0.03 | 1.00 | | | |
| *Alpha_7Factor* | -0.12 | -0.05 | 0.02 | -0.11 | 0.27 | 1.00 | | |
| *Appraisal_Ratio* | -0.05 | -0.01 | 0.02 | -0.10 | 0.30 | 0.78 | 1.00 | |
| *StdRet* | -0.13 | -0.10 | -0.08 | -0.05 | -0.03 | 0.32 | -0.22 | 1.00 |

Table II

# Manager Trustworthiness and Fund Flows

This table reports average Fama-MacBeth OLS estimates with net flow as a dependent variable. The sample period is from January 2000 to December 2009. Net flows into each fund are defined as the percentage change of net assets of the fund between the beginning of a year and the end of a year net of yearly returns. The independent variables include three terciles of performance ($Low(t-1)$, $Mid(t-1)$ and $High(t-1)$) at the end of year *t-1*, standard deviation of monthly returns during year *t-1*, natural logarithm of assets under management at the end of year *t-1*, and median of the flows during year $t$ for the funds following the same investment style. Standard errors are computed using Newey-West (1987) with one lag. t-statistics are reported in the parentheses. 1%, and 5% statistical significance are indicated with ***, and ** respectively.

| | All Funds | | | | Live Funds | |
|---|---|---|---|---|---|---|
| | | Fama- MacBeth | | Pooled Panel | Fama- MacBeth | |
| | 1 | 2 | 3 | 4 | 5 | 6 |
| Intercept | 1.929*** | 1.274 | 1.323 | 1.281 | 1.624 | 1.619 |
| | (2.92) | (0.95) | (0.96) | (1.59) | (1.34) | (1.32) |
| $Low(t-1)$ | 0.224 | 3.046 | 3.073 | 2.322 | 2.385 | 2.492 |
| | (0.89) | (0.83) | (0.82) | (1.24) | (0.76) | (0.80) |
| $Mid(t-1)$ | 0.126 | -2.634*** | -2.682*** | -2.511** | -3.542*** | -3.446** |
| | (0.60) | (-2.67) | (-2.82) | (-2.37) | (-2.67) | (-2.48) |
| $High(t-1)$ | 1.131*** | 7.113* | 6.830 | 6.803* | 5.269 | 5.660 |
| | (2.75) | (1.81) | (1.63) | (1.69) | (1.01) | (0.96) |
| *StdRet* | -1.802 | -2.020** | -2.134** | -1.205** | -1.456 | -1.815* |
| | (-1.55) | (-1.84) | (-1.95) | (-2.35) | (-1.40) | (-1.66) |
| $Log(AUM(t-1))$ | -0.106*** | -0.105*** | -0.106*** | -0.093*** | -0.096*** | -0.095*** |
| | (-3.71) | (-3.70) | (-3.66) | (-3.72) | (-4.33) | (-4.20) |
| $Flows(t-1)$ | 0.156*** | 0.152*** | 0.148*** | 0.166*** | 0.140*** | 0.129*** |
| | (4.95) | (5.09) | (4.87) | (6.45) | (5.25) | (4.56) |
| $Median\_StyleFlow$ | 0.488 | 0.469 | 0.467 | 1.399*** | 0.733 | 0.729 |
| | (1.55) | (1.50) | (1.42) | (5.06) | (1.63) | (1.52) |
| $Mean\_Trust$ | 0.006 | 0.125 | 0.122 | 0.054 | 0.024 | 0.029 |
| | (0.13) | (0.63) | (0.60) | (0.54) | (0.16) | (0.19) |
| $Fund\_Age$ | -0.006 | -0.005 | -0.006 | -0.006 | -0.011 | -0.009 |
| | (-1.61) | (-1.26) | (-0.69) | (-1.56) | (-1.77) | (-0.70) |
| $Low * Mean\_Trust$ | | -0.512 | -0.502 | -0.324 | -0.347 | -0.384 |
| | | (-0.83) | (-0.80) | (-0.95) | (-0.65) | (-0.75) |
| $Mid * Mean\_Trust$ | | 0.484*** | 0.482*** | 0.476*** | 0.667*** | 0.665*** |
| | | (3.00) | (3.30) | (2.70) | (3.09) | (3.20) |
| $High * Mean\_Trust$ | | -1.062 | -1.013 | -1.051 | -0.795 | -0.761 |
| | | (-1.58) | (-1.41) | (-1.48) | (-0.91) | (-0.75) |
| $Low * Fund\_Age$ | | | -0.008 | | | -0.001 |
| | | | (-0.22) | | | (-0.03) |
| $Mid * Fund\_Age$ | | | 0.009 | | | -0.016 |
| | | | (0.20) | | | (-0.31) |
| $High * Fund\_Age$ | | | 0.002 | | | -0.097* |
| | | | (0.03) | | | (-1.65) |
| Num of Obs | 1815 | 1815 | 1815 | 1815 | 1454 | 1454 |
| Years | 10 | 10 | 10 | 10 | 10 | 10 |
| AVG $R^2$ | 22.72 | 24.19 | 25.88 | 18.67 | 27.34 | 29.59 |

Table III

# Manager Trustworthiness and Fund Survival

The dependent variable is the probability that the fund dies or drops off the database in a given year t. The explanatory variables include manager trustworthiness and other fund characteristics. See Table I for definitions of these variables. $StdRet(t-1)$ is estimated using the monthly returns data from year *t-1*. We also include strategy and year dummies as control variables. The value of a strategy dummy is 1 if the fund belongs to that strategy and 0 otherwise. Likewise, the value of a year dummy is 1 if the observation belongs to that year. p-values are reported in parentheses. 1%, and 5% statistical significance are indicated with ***, and ** respectively.

| | Dependent Variable Prob (Dead=1) | | | |
|---|---|---|---|---|
| | | | Abret<0 | Abret>=0 |
| | 1 | 2 | 3 | 4 |
| Intercept | 0.6551 | 0.473 | -6.233 | 1.309 |
| | (0.42) | (0.56) | (0.97) | (0.34) |
| $Mean\_Trust$ | 0.1352 | 0.158 | 0.621*** | -0.078 |
| | (0.21) | (0.14) | (0.00) | (0.71) |
| $AbRet(t-1)$ | -0.7784** | -5.774 | -16.613** | -10.855 |
| | (0.03) | (0.13) | (0.01) | (0.25) |
| $Mean\_Trust * AbRet(t-1)$ | | 0.899 | 2.592** | 1.752 |
| | | (0.19) | (0.02) | (0.29) |
| $Flow(t-1)$ | -0.4964*** | -0.509*** | -0.762*** | -0.465** |
| | (0.00) | (0.00) | (0.00) | (0.01) |
| $StdRet(t-1)$ | 1.618 | 1.439 | -2.626 | 6.125* |
| | (0.47) | (0.52) | (0.54) | (0.09) |
| $Fund\_Age(t-1)$ | -0.00099 | -0.001 | -0.002 | -0.0002 |
| | (0.37) | (0.33) | (0.27) | (0.89) |
| $Log(AUM(t-1))$ | -0.113*** | -0.111*** | -0.179*** | -0.062 |
| | (0.00) | (0.00) | (0.00) | (0.14) |
| Strategy Dummies | Yes | Yes | Yes | Yes |
| Year Dummies | Yes | Yes | Yes | Yes |
| N | 2030 | 2030 | 884 | 1146 |

Table IV

# Manager Trustworthiness and Fund Performance

This table presents the results of OLS regressions with a measure of fund performance as a dependent variable. The measures of fund performance included are *Alpha*, *Appraisal_Ratio* and *Alpha_Strategy*. These measures of fund performance were calculated using monthly returns from the entire fund history. See Table 1 for definitions of these return measures and other variables. The t-statistics (reported in parentheses) are based on standard errors clustered at the Management Firm level. 1%, and 5% statistical significance are indicated with ***, and ** respectively.

| | All Funds | | | | Live Funds | |
|---|---|---|---|---|---|---|
| | Dependent Variable | | | | | |
| | *Alpha_7Factor* | *Alpha_7Factor* | *Alpha_7Factor* | *Appraisal_Ratio* | *Alpha_7Factor* | *Appraisal_Ratio* |
| *Intercept* | 0.0196*** | 0.0008 | -0.0077* | 0.4331 | 0.0073 | 0.6274** |
| | (3.58) | (0.12) | (-1.68) | (1.52) | (1.13) | (2.38) |
| *Mean_Trust* | -0.0024** | -0.0017** | | -0.0906** | -0.0015* | -0.0638* |
| | (-2.49) | (-2.09) | | (-2.17) | (-1.72) | (-1.90) |
| *Trust_Rank* | | | -0.0031*** | | | |
| | | | (-3.31) | | | |
| t *Log(AUM)* | | 0.0007*** | 0.0007*** | 0.0245*** | 0.0004* | 0.0146** |
| | | (2.59) | (2.72) | (3.01) | (1.83) | (2.07) |
| *StdRet* | | 0.079*** | 0.079*** | -2.163*** | 0.0962*** | -3.094*** |
| | | (3.46) | (3.54) | (-3.38) | (3.67) | (-4.10) |
| *Fund_Age* | | -0.0001 | -0.0001 | -0.0054 | -0.0002** | -0.0146*** |
| | | (-0.63) | (-0.60) | (-1.00) | (-2.37) | (-2.85) |
| Clustered(Mgmt_Firm) | Yes | Yes | Yes | Yes | Yes | Yes |
| N | 625 | 587 | 587 | 587 | 397 | 397 |
| R2 (%) | 1.58 | 8.53 | 10.32 | 5.20 | 13.01 | 11.26 |

Table V

# Manager Trustworthiness and Performance Persistence

This table presents results from Probit regressions with the probability of performance persistence as a dependent variable. Fund is defined as a winner in any given year if the return of the fund in that year is above the median of the returns of the funds following the same strategy. Similary, a fund is defined as a loser if its return is below the median of the returns of the same strategy funds in that year. Prob (WW=1) denotes the conditional probability that a fund is winner in year t given that it was a winner in year *t-1* and likewise Prob (LL=1) denotes the conditional probability that a fund is loser in year t given that it was a loser in year *t-1*. $Mean\_Trust$ is a measure of manager trustworthiness estimated by averaging the participants' responses to Question 1 of the trust survey shown in Appendix A . $AUM(t-2)$ is the assets under management of the fund at the end of year *t-2*. FundAge is the age of the fund in years. $StdRet(t-2)$ is the standard deviation of monthly returns estimated using the returns data from year *t-2*. 1%, and 5% statistical significance are indicated with ***, and ** respectively.

| | Dependent Variable | | | | |
|---|---|---|---|---|---|
| | Prob(LL=1) | Prob(LL=1) | Prob(LL=1) | Prob(WW=1) | Prob(WW=1) |
| *Intercept* | -0.6722 | -0.6678 | -0.8261 | 1.0593** | 1.7116** |
| | (0.14) | (0.14) | (0.28) | (0.05) | (0.02) |
| $Mean\_Trust$ | 0.1561** | 0.1512** | 0.1698** | -0.0429 | 0.0186 |
| | (0.02) | (0.03) | (0.04) | (0.47) | (0.81) |
| $Log(AUM(t-2))$ | | | -0.0062 | | -0.0567 |
| | | | (0.83) | | (0.03) |
| $StdRet(t-2)$ | | | 0.041 | | -1.396 |
| | | | (0.98) | | (0.38) |
| $Fund\_Age(t-2)$ | | 0.0003 | 0.0007 | | 0.0002 |
| | | (0.67) | (0.39) | | (0.78) |
| Strategy Dummies | Yes | Yes | Yes | Yes | Yes |
| N | 1333 | 1333 | 851 | 1708 | 1032 |

Table VI
# Performance Smoothing

This table presents stimates from OLS regressions where the dependent variable is our three smmothing smoothing measures and the independent variable are out trsut measure ($Mean\_Trust$), log of assets under management ($LogAUM$)and fund age in years ($Fund\_Age$).

The first smoothing measure is the monthly first order serial correlation ($\hat{\rho_1}$) of reported returns, which we estimate over the entire history of returns available on TASS, We estimate the other two measures following Getmansky et al. (2004) and Cassar and Gerakos (2011). We assume that actual monthly performance innovations are independently and normally distributed, but are smoothed using a Moving Average model with two lags:

$$X_t = \theta_0\eta_t + \theta_1\eta_{t-1} + \theta_2\eta_{t-2}$$
$$1 = \theta_0 + \theta_1 + \theta_2$$
$$\eta_t \sim Nor(0, \sigma_\eta^2)$$

We estimate the moving average coefficients using Maximum Likelihood and then transform the estimated coefficients by dividing $\hat{\theta_i}$ each by $1 + \hat{\theta_1} + \hat{\theta_2}$ to normalize them. Our second smoothing measure is the first coefficient $\hat{\theta_i}$ from the above estimation. $\hat{\theta_i}$ represents the percentage of the monthąęs actual performance innovation that is included in the reported return. Our third measure is the Herfindahl Index measure of the concentration of the $\theta_k$ weights:

$$\xi = \sum_{j=0}^{2} \theta_j^2$$

Lower values of $\xi$ represent greater smoothing. We winsorize all three measures to the 1st and 99th percentiles. 1%, and 5% statistical significance are indicated with ***, and ** respectively.

| | Dependent Variable | | |
|---|---|---|---|
| | $\hat{\rho_1}$ | $\hat{\theta_0}$ | $\hat{\xi}$ |
| *Intercept* | -0.055 | 0.064 | 0.019 |
| | (-0.40) | (0.47) | (0.28) |
| $Mean\_Trust$ | 0.012 | -0.007 | -0.006 |
| | (0.85) | (-0.87) | (-0.63) |
| $Log(AUM)$ | 0.019*** | -0.014*** | -0.012*** |
| | (3.56) | (-4.12) | (-3.92) |
| $Fund\_Age$ | 0.001 | -0.000 | -0.001 |
| | (0.49) | (-0.17) | (-0.35) |
| N | 639 | 639 | 639 |
| AVG $R^2$ | 0.5 | 0.6 | 0.5 |

Table VII
# Incentives

This table presents the results from regressions where the dependent variable is one of the following characteristics of the hedge fund manager's incentive contract: Incentive Fees, Management Fees, High-water mark ($HWM$), Partner Capital, Lockup period and Restriction period. The incentive variables are from the most recent snapshot of TASS data from December 2009 and the sample includes both the live and dead funds. The independent variables are our trust measure ($Mean\_Trust$), log of assets under management ($logAUM$), standard deviation of monthly returns ($StdRet$), fund flows (Flow(t-1) over the last year, abnormal return over the life of fund (Alpha) and log of fund age ($log(Fund\_Age)$). Columns 3 and 4 present the results from a Probit regression.1%, and 5% statistical significance are indicated with ***, and ** respectively.

| | Dependent Variable | | | | | |
|---|---|---|---|---|---|---|
| | | | Probit | Probit | | |
| | Inc_Fee | Mgmt_Fee | HWM | Partner Capital | Lockup Period | Restriction Period |
| Intercept | 8.93 | 0.26 | -0.04 | -2.70 | -3.00 | -13.45 |
| | (1.10) | (0.52) | [1.00] | [0.99] | (0.40) | (-0.42) |
| $Mean\_Trust$ | 0.09 | -0.0005 | -0.73*** | -0.12 | -1.23 | -3.74* |
| | (0.21) | (-0.01) | [0.00] | [0.42] | (-1.65) | (-0.93) |
| $Flow(t-1)$ | 0.01 | -0.02 | -0.15 | -0.08 | -1.06** | -6.02** |
| | (0.03) | (-0.80) | [0.29] | [0.49] | (-1.96) | (-2.55) |
| $Log(AUM)$ | -0.05 | 0.04*** | 0.05 | -0.06 | 0.49** | 0.76 |
| | (-0.25) | (2.64) | [0.49] | [0.21] | (2.14) | (0.71) |
| $StdRet$ | -3.29 | 1.39 | -4.77 | 3.35 | 32.44** | 117.51 |
| | (-0.28) | (1.40) | [0.34] | [0.28] | (2.17) | (1.42) |
| $Log(Fund\_Age)$ | 0.90 | 0.10 | 1.33*** | 0.03 | 1.97 | 18.16*** |
| | (0.80) | (1.26) | [0.00] | [0.90] | (1.54) | (3.62) |
| $Alpha$ | 95.19** | 5.50* | 26.64 | 28.07** | 103.34* | 604.10* |
| | (2.40) | (1.90) | [0.13] | [0.01] | (1.66) | (1.90) |
| $LockupPeriod$ | | | 0.11*** | | | |
| | | | [0.00] | | | |
| $RestrictionPeriod$ | | | 0.01*** | | | |
| | | | [0.00] | | | |
| Strategy Dummies | Yes | Yes | Yes | Yes | Yes | Yes |
| Inception Year Dummies | Yes | Yes | Yes | Yes | Yes | Yes |
| N | 353 | 353 | 353 | 353 | 353 | 353 |
| $R^2$ (%) | 17.8 | 32.7 | | | 19.9 | 26.0 |