Liquidity Demand and Provision among Mutual Funds and Long-Term Savings Institutions

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Abstract

The paper investigates the relationship between net flows to mutual funds, transactions of mutual funds, and transactions of long-term saving institutions (LT) such as pension funds. The analysis utilizes two Israeli proprietary databases containing daily data on flows and transactions by investor type. The findings reveal a negative correlation between LT transactions and mutual fund flow-driven transactions, while there is no correlation with non-flow-driven transactions. Additionally, mutual fund flow-driven transactions demonstrate a positive correlation with the contemporaneous stock market return, with a stronger effect observed when LT takes the opposite side of these transactions. This effect accounts for 25% of the daily return variance. This return effect is completely reversed within 10 trading days, indicating a correction of price pressure "noise". Lastly, the study uncovers that these effects were amplified during the Covid-19 crisis period. Overall, these findings emphasize the role of long-term saving institutions as stabilizers of the stock market.