Unrealized Gains, Fund Distribution, and Mutual Fund Flows[1]

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Abstract

This study examines whether mutual fund flows respond around the zero unrealized-gain threshold and whether such responses reflect investor behavior or fund distribution. We construct a fund-level proxy for investors' average book-price basis and define an unrealized gain ratio. We then estimate regression discontinuity and regression kink designs around the break-even point at which the fund price equals the estimated average purchase price. Using daily data on Japanese equity mutual funds, we show that gross inflows of stock active funds display economically and statistically meaningful threshold-related responses, especially among younger funds and when recent returns are nonnegative. Under these conditions, inflows exhibit both a positive jump and a negative kink at the cutoff. In contrast, passive funds show much weaker responses, and outflow responses are substantially weaker overall. Because individual investors have heterogeneous acquisition costs and are unlikely to condition directly on a common fund-level average purchase price, these findings are difficult to reconcile with a purely investor-side interpretation. Instead, the results suggest that the zero unrealized-gain threshold captures variation in the ease of fund distribution and marketing. This study contributes to the flow-performance and mutual fund distribution literatures by identifying a local, threshold-based channel through which intermediary behavior may shape retail fund demand.

Keywords: Mutual fund flows; Unrealized gains; Fund distribution; Regression discontinuity design; Regression kink design; Retail investors; Active and passive funds

JEL Codes: G11; G23; D14; D91

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