

Abstract

This paper examines how mutual fund managers and investors respond to U.S.–China geopolitical risk. I construct a novel bilateral geopolitical risk index from White House press briefings and develop a measure that isolates fund managers' active reallocation decisions from fund flows and price movements. When risk rises, U.S. managers reduce allocations to Chinese equities, reallocate from Asia high- to low-risk regions, and shift domestic holdings toward firms with lower exposure to China. Chinese managers pull back from local markets but maintain U.S. exposure. These responses are more pronounced after 2018. U.S. mutual fund investors are more sensitive to geopolitical risk than Chinese investors. The findings demonstrate geopolitical risk significantly influences international capital allocation. They also reveal heterogeneous responses across countries and investor types.

Motivation & Research Questions

Geopolitical risk has become a persistent and economically meaningful source of uncertainty for global investors, especially amid rising U.S.–China tensions. Mutual funds provide a unique laboratory to study who responds to geopolitical risk: fund managers through portfolio reallocation, and investors through fund flows.

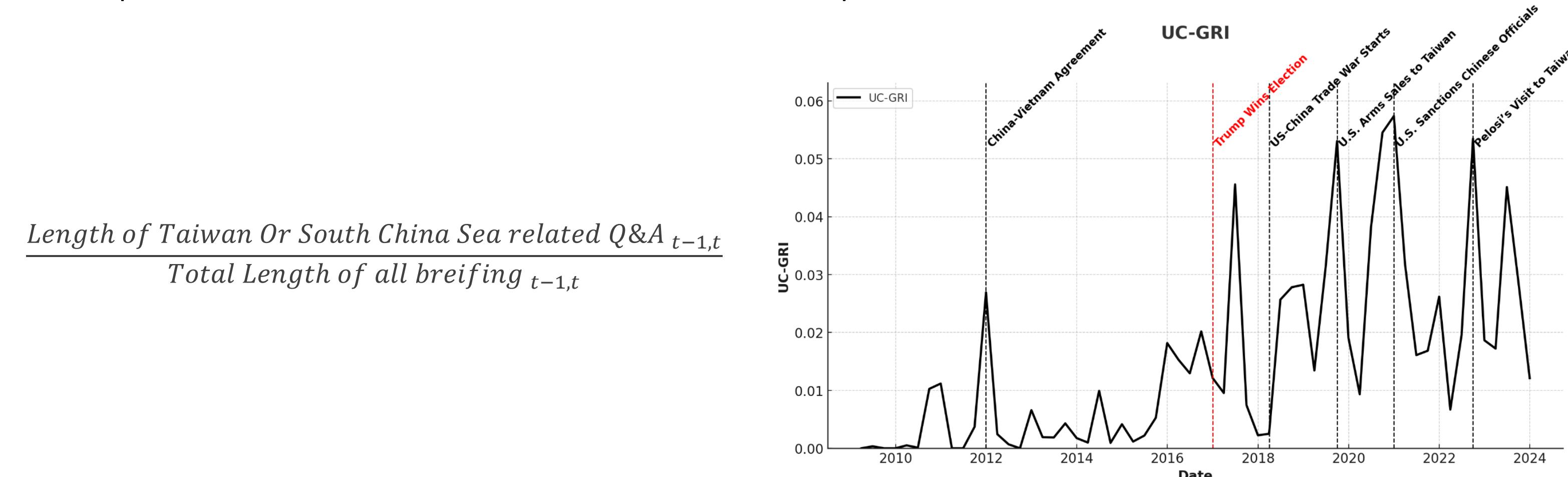
- How does U.S.–China geopolitical risk influence mutual fund capital allocation?
- How do reallocations differ across regions and within U.S. stocks?
- Do fund investors care about geopolitical risk?
- How do U.S. and Chinese fund managers/investors differ in their reactions?

Contribution

- I show that geopolitical risk plays a key role in shaping mutual fund managers' and investors' international allocations.
- I show that investors incorporate geopolitical risk into their decisions rather than relying solely on return-based heuristics.
- I introduce two new measures, the Fund Manager Active Reallocation (FMAR) and the bilateral U.S.–China Geopolitical Risk Index (UC-GRI).
- I highlight heterogeneous responses across investor types, and countries.

U.S.–China Geopolitical Risk Index (UC-GRI)

- **Data:**
White House press briefings (2009–2023) (Q&A)
- **Method:**
Identify Q&A pairs mentioning “Taiwan,” or “South China Sea.”
Compute share of China-related content in total text each quarter.



Fund Manager Active Reallocation (FMAR)

- **Goal:** Quantify managers' active reallocations across regions, net of price and flow effects.
- Mutual Funds are required to disclose their holding information each quarter.
- **Changes in a fund's holdings reflect three forces:** investor flows, asset price movements, and the manager's own reallocation decisions.
- FMAR isolates the manager's intentional shift in regional exposure—the true active response to risk.
- **Assumption:** Investor flows are assumed to be allocated proportionally to the existing portfolio at time $t-1$ (or t).

$$FMAR_{i,S,t-1,t} = \frac{P_t^F Q_t^F - P_{t-1}^F Q_{t-1}^F}{TV_{t-1}} - \frac{Flow_{t-1,t} \frac{P_t^F Q_t^F}{TV_t}}{TV_{t-1}} - \frac{Q_{t-1}^F (P_t^F - P_{t-1}^F)}{TV_{t-1}}$$

Change of Value Fund Flow Driven Change Price Driven Change

Results

Result 1: U.S. Fund Managers' Response

- **Specification:**

$$FMAR_{i,S,t-1,t} = \alpha_i + \beta_1 UCGRIT_{-1,t} + Controls + \varepsilon_{t-1,t}$$

- **Controls include:**

Macro: Risk Free Rate, US–China Stock Market Return Gap, Global Geopolitical Risk Index (Caldara and Iacoviello (2020))
Micro: Fund Size, Fund Past Performance, Fund Age

- **Key Findings:**

U.S. fund managers reduce allocations to Chinese equities when U.S.–China geopolitical risk rises. They reallocate away from higher-risk Asian markets toward safer markets. Within U.S. equity holdings, managers tilt toward firms with lower exposure to China.



	US (1)	US (Risk) (2)	US (noRisk) (3)	China (4)	HK (5)	High Risk (6)	Low Risk (7)
UC-GRI	0.0099	-0.3331***	0.2736***	-0.0397***	-0.0084*	-0.0093*	0.0150***
Control	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Fund Fixed	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Result 2: U.S. Fund Investors' Response

- **Specification:**

$$Flow_{i,t-1,t} = \alpha_i + \beta_1 UCGRIT_{-1,t} + \beta_2 SecPct_{S,t-1} + \beta_3 SecPct_{S,t-1} * UCGRIT_{-1,t} + Controls + \varepsilon_{t-1,t}$$

The key coefficient here is β_3 . It tests whether fund flows respond to geopolitical risk conditional on a fund's prior exposure to the region. A negative estimate implies that when UC-GRI rises, investors withdraw capital from funds more exposed to the target markets.

- **Key Findings:**

U.S. fund investors display a stronger home preference as U.S.–China geopolitical risk rises, but do not distinguish among funds based on their China exposure.

	US (1)	US (Risk) (2)	US (noRisk) (3)	China (4)	HK (5)	High Risk (6)	Low Risk (7)
UC-GRI* Target Stock %	0.2381***	0.2170*	0.3012***	-0.2945	-3.9071***	0.3147	-1.5272***
Control	Yes	Yes	Yes	Yes	Yes	Yes	Yes
FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Result 3: Chinese Fund Manager and Investor (QDII Fund) Response

- **Key Findings:**

- Chinese fund managers reduce domestic and Hong Kong equity exposure but maintain their U.S. holdings when U.S.–China geopolitical risk rises.
- Chinese mutual fund investors exhibit little reaction, with fund flows remaining largely unchanged.

	US (1)	China (2)	HK (3)	High Risk Region (4)	Low Risk Region (5)
UC-GRI	0.2892	-1.0196***	-0.2283***	0.15	0.0056
Control	Yes	Yes	Yes	Yes	Yes
FE	Yes	Yes	Yes	Yes	Yes
	US (1)	China (2)	HK (3)	High Risk Region (4)	Low Risk Region (5)
UC-GRI* Target Stock %	-1.5908	1.6315	-1.6682	0.4956	-7.7481***
Control	Yes	Yes	Yes	Yes	Yes
FE	Yes	Yes	Yes	Yes	Yes

Conclusions

- Geopolitical risk has become a systematic determinant of mutual fund behavior across countries.
- U.S. managers selectively reallocate away from China and high-risk regions toward safer markets.
- Chinese managers pull back from China and Hong Kong but show limited reallocation to low-risk regions.
- Investor reactions differ sharply: U.S. investors exhibit home preference reallocations, while Chinese investors' responses remain muted under QDII and capital controls.
- Heterogeneity: Responses vary across countries, investor types, and risk exposures.