

CONSUMERAFFAIRS

Article Navigation



Study: Hedge funds manipulate stock prices

Ohio State researchers find evidence of 'portfolio pumping'

12/11/2012 | ConsumerAffairs | [Personal Finance \(http://www.consumeraffairs.com/news_index/financial.html\)](http://www.consumeraffairs.com/news_index/financial.html)



By Mark Huffman

Mark Huffman has been a consumer news reporter for ConsumerAffairs since 2004. He covers real estate, gas prices and the economy and has reported extensively on negative-option sales. He was previously an Associated Press reporter and editor in Washington, D.C., a correspondent for Westwood One Radio Networks and Marketwatch. [Read Full Bio→ \(http://www.consumeraffairs.com/about/staff/mark-huffman/\)](http://www.consumeraffairs.com/about/staff/mark-huffman/)

[Email Mark Huffman \(mailto:mark.huffman@consumeraffairs.com\)](mailto:mark.huffman@consumeraffairs.com) Phone: 866-773-0221

Since the start of the Great Recession, many consumers, known as “retail” investors, have shunned the stock market. Many are suspicious that Wall Street is simply fixed against the small investor.

A study by researchers at [Ohio State's \(http://www.osu.edu\)](http://www.osu.edu) business school gives that theory some credibility. In particular, it found that some hedge funds manipulate stock prices at the end of the month to improve the returns that they report to their investors.



In a study of 10 years of hedge fund data, researchers found evidence that some funds run up prices on specific stocks they hold on the last day of the month and quarter -- especially the last 20 minutes of trading -- before they report their returns for the period. But the prices usually fall back the next day, after the abnormally large returns have already been reported to investors.

“Some hedge funds that do this are trying to make themselves look more successful than they really are,” said Itzhak Ben-David, an author of the study and assistant professor of finance at Ohio State University’s

Fisher College of Business. “What this means is that investors could be getting the wrong messages about the quality of the hedge fund. They’re not getting a clear picture of how the fund is doing.”

Portfolio pumping

It's known as “portfolio pumping” and it's not uncommon, Ben-David said. The study found that stocks that have the most hedge fund ownership -- in the top 25 percent -- see on average an abnormal return of 0.30 percent on the last day of the quarter, most of which reverts back the very next day of trading.

A hedge fund is an investment fund open only to certain large, mostly institutional investors. Because they invest massive amounts of money, they can easily move the market.

Hedge funds didn't start this practice. In the past, some mutual funds did the same thing until the Securities and Exchange Commission (SEC) cracked down on the practice in 2001. But this research suggests that hedge funds are undeterred.

“This is a legal gray area. I think if a hedge fund were to be seen doing this systematically, the SEC would be interested in investigating,” Ben-David said.

Paper trail

There was quite a paper trail for the researchers to follow. In looking at mandatory institutional quarterly portfolio holdings reports and information about hedge fund characteristics and performance from 2000 to 2010, Ben-David said he and his colleagues found evidence of very large stock orders on the last trading days of a month and quarter -- orders that were big enough to move the stock prices. Most, he said, took place in the last 20 minutes of trading.

Seeing the sharp upward move, a small investor might be led to believe the stock was moving higher and be influenced to purchase shares. On the next day of trading, however, the share prices inevitably fell.

While portfolio pumping hurts investors, by relying on misstated returns and risk, it can benefit the hedge fund managers whose compensation is tied to end-of-month performance. It can also help companies whose stock prices rise at the end of reporting periods, as some financial contracts may rely on end-of-month stock prices -- even if they fall right back the next day.