Discussion of Cao, Wermers, and Ze "Winning at the starting line…"

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Bottom line up front

- Authors study the role of municipal bond mutual funds in the primary market for municipal bonds.
- This paper uses the SEC's N-CEN data. Mutual funds have to report each year the ten entities with which they do the largest total transaction amounts.
- N-CEN is the updated version of the previous (semiannual) N-SAR filing mutual funds were required to make.
- With these data the authors create a database of the intensity of mutual fund-dealer interaction.
- New issues that mutual funds purchase from dealers with whom they have had high-intensity relationships are underpriced relative to other new issues they buy.

Data example: most recent filing for Nuveen Kentucky Municipal Bond Fund ($290 million portfolio)

Dealer	Par value of trades	Percent of total
Morgan Stanley	$28.924 M	26.7%
Bank of America	11.885 M	11.0%
RBC Capital Markets	9.629 M	8.9%
KeyBanc Capital Markets	7.127 M	6.6%
Loop Capital Markets	6.962 M	6.4%
Pershing LLC	6.417 M	5.9%
Mesirow Financial	6.240 M	5.8%
Wells Fargo Securities	6.203 M	5.7%
Huntington Securities	5.542 M	5.1%
National Financial Services	5.169 M	4.8%

Key Tables: Table 5 and Table 7

- Authors create a dataset where each observation is a fund's holding of a newly issued bond. The thirty-day post-issuance price increase appears to be higher for fund-new bond pairs where the underwriter sells a new bond to a mutual fund with which it has a higher intensity of previous connections.

Key Tables: Table 5 and Table 7

30-day post-issuance price increase is higher for bonds that mutual funds purchase from dealers with whom they have Interacted frequently

TABLE 5: **The Benefit of Primary Market Allocation in Fund Holdings**

The table reports fund-quarter-holdings panel regression results of Equation (6) using our sample of U.S. municipal bond mutual funds from Jan. 2005 to Dec. 2019. The sample starts in 2005 to match the sample period of transaction data in MSRB. The sample includes only holdings of newly issued municipal bonds. In Column (1) - (3), the dependent variable is the overall returns of newly issued municipal bonds in the first 30 days after issuance defined in Equation (3). In Column (4) - (5), the dependent variable is the overall profit gained for each holdings of newly issued municipal bond defined in Equation (4). All variables are winsorized at 0.5% of both tails. Standard errors clustered by time and fund are reported in the brackets under each coefficient. Stars denote standard statistical significance (***$p < 0.01$, **$p < 0.05$, *$p < 0.1$, respectively).

Dependant Var:	Overall Return (%)			Overall Profit ($ Thousands)	
	(1)	(2)	(3)	(4)	(5)
Portfolio weight (%)	0.0103				
	(0.0163)				
$1_{\text{connected}}$		0.1390***		9.6939***	
		(0.0163)		(1.4000)	
$N_{\text{connections}}$			0.0538***		4.3050***
			(0.0048)		(0.4511)

Other results:

- Table 3: conditional on purchasing *any* amount of a new bond issue, mutual funds purchase more of new bond issues that are underwritten by dealers with whom they have previously done a lot of trading.
- Tables 9 and 12: getting new issues does not automatically boost fund performance, getting new issues from dealers with whom funds are connected does.

Comments/questions

- Paper is well-crafted and I find these results plausible.
- Questions:
  - How common is it to buy new issues from dealers with whom a fund has had minimal connections? Why might a fund do this?
  - Is the unit of analysis the fund or the fund management team?
  - Can we pick this result apart, find out particular subsamples that drive the results
    - A subset of dealers?
    - A subset of funds?
    - A subset of types of bonds?
    - A subset of time periods/market and dealer balance sheet conditions?