Economic Policy Uncertainty and Global Portfolio Allocations

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Abstract

We examine how global institutional funds respond to news-based economic policy uncertainty (EPU) in their investment destinations. On average, we find a negative flow-EPU relationship for global funds, with that negative response being weaker for destinations which are more familiar, share similar legal and cultural origins, have strong democratic government and legal rights, and are more informationally transparent. We document a significant transmission of EPU shocks internationally *via* multi-country presence of the global institutional funds. We provide novel evidence as to how local EPU shock in one geography alters the investment decisions of the global funds in unaffected geographies. We also document significant pricing implications for the US stocks due to its exposure to the external EPU shocks through its global institutional owners. Lastly, we show that the ex-ante local EPU shocks exacerbates the capital retrenchment from emerging markets after a global liquidity event, such as taper tantrum. Overall, ours is the first study to shed light on the importance of local EPU shocks for the equity allocations of global funds across countries.

1 Introduction

Cross-border capital flows to fund investments in both debt and equity have become increasingly common over time. For instance, global mutual funds' total foreign asset holdings have increased from \$13.63 trillion in 1997 to \$75.84 trillion in 2018. While cross-currency carry strategies are known to be widespread (Lustig, Roussanov, and Verdelhan (2011)), as well as the tendency of investors to prefer securities denominated in their home currency (Maggiori, Neiman, and Schreger (2020)), the determinants of cross-border capital flows by institutional investors (e.g., equity mutual funds) are much less understood. In this paper, we seek to understand one important facet of such cross-border investments: the impact of economic policy uncertainty on the global asset allocation decisions of institutional funds, such as mutual funds and hedge funds.

The relationship between economic policy uncertainty and global asset allocation is of significant interest to both regulatory bodies and global investors, as cross-border capital flows create financial linkages that may result in the propagation of financial shocks across countries. For instance, De Haas and Van Horen (2012) and Cetorelli and Goldberg (2011) document the transmission of the 2008 financial crisis to other countries, and, especially, to emerging economies through the lending activity of global banks. However, surprisingly little is known regarding the role of institutional investment funds in the propagation of financial shocks. In this paper, we document a novel channel of transmission of economic uncertainty-related shocks through the portfolio decisions of global institutional funds.

Our paper aims to shed light on the following questions. First, how do the equity investments of institutional investors in foreign countries respond to a rise in the foreign country's economic policy uncertainty (EPU), as measured by economic news relevant to governmental economic policies? We examine the two economic channels behind the fund-response-EPU relationship: "home-bias" and "flight-to-safety." Funds may behave differently in their capital allocation decisions when exposed to a greater level of EPU in their country of domicile vs. that of foreign countries, and does this dichotomy depend on the status of foreign countries—i.e., advanced (generally seen as safe-heavens) vs. emerging? Third, does the strength of the investment country's legal/political institutions and cultural proximity to an investor's home country impact how funds respond to an increased EPU in the investment destination? Finally, are there spillovers in global portfolio allocations related to EPU? In other words, does increased exposure to EPU through one country in an institutional portfolio affect its capital allocation in other countries?

To this end, we match security-level global fund data for various institutional investors from the Thomson Reuters Global Ownership database with the news-based economic policy uncertainty (EPU) measure created by Baker, Bloom, and Davis (2016). EPU index quantifies newspaper coverage of policy-related economic uncertainty, arguably capturing the relevant uncertainty for the long-term global institutional investors.[1] We focus on portfolios of individual mutual funds, hedge funds, and investment advisors. For ease of reference, we refer to each institutional investor as a "fund".

We begin by examining the impact of EPU in the destination country on the capital allocation decisions of the global funds. Novel to the fund literature, we observe a fund's capital allocation across multiple destinations at a point in time. By absorbing $fund \times time$ fixed effect, similar to Khwaja and Mian (2008), Jiménez, Ongena, Peydró, and Saurina (2012), we identify the impact of EPU on the fund's capital allocation decision by comparing how the same fund's investment differs across geographies that are differentially exposed to EPU shocks at a point time. Importantly, our estimation controls for any time-varying fund-specific factors that affects its capital allocations in general, such as time-varying liquidity shocks or time-varying risk aversion affecting manager's allocation across all the geographies.

[1]We obtain the data on EPU index across 21 countries which also form the set of investment destinations we focus on. These 21 destination countries together account for 85.57% of the global asset holdings, by AUM, in our sample. The EPU data is publicly available at a monthly frequency for 21 countries. See https://www.policyuncertainty.com/ Table 1 lists the 21 countries. Our sample has 1,122 Host-Country $\times$ Destination-Country unique pairs. For a typical fund, investment in these 21 destination countries in our sample accounts for about 82% of its total AUM.

To fix ideas, suppose Fund A withdraws 20% and 10% of its capital from two destinations X and Y where it is active at a point in time. Further X and Y experiences EPU of 10 and 12 units respectively. Then our "within-fund" strategy estimates the effect as 5% ($= \frac{(20\% - 10\%)}{(12 - 10)} = 5\%$) incremental capital withdrawal for one unit higher EPU. In addition, we also control for "destination" fixed effects which absorb any time-invariant differences across investment countries.[2]

Our key result is that a unit standard deviation increase in the destination EPU is associated with a decrease of 1.27% in fund's capital flows to that destination during the subsequent quarter (relative to the fund's other investment destinations). This a large effect relative to the sample's median quarterly flow into a target investment country of 1.39%. The negative relationship between EPU and global fund flows is robust to controlling for a battery of destination-level time-varying controls capturing financial conditions (exchange rate, equity market performance, and interest rates) and economic growth (industrial growth).

To tackle the particular concern that the fund's investment into a particular destination is a result of endogenous matching, we show that our results are robust to absorbing *fund-destination* pair fixed effects. These fixed effects account for any time-invariant heterogeneity in fund flows into a destination country, such as destination-specific expertise, geographic familiarity, cultural linkages, or trust. This is important because the literature on determinants of cross-border investments shows that such time-invariant factors are strongly correlated with cross-border financial linkages (e.g., Guiso, Sapienza, and Zingales (2009), Papaioannou (2009)). Finally, the negative flow-EPU relationship hold for both funds domiciled inside and outside the U.S.

We examine the economic channels that may help explain the cross-country variation in negative flow-EPU relationship. First, we study if there is any "home-bias" in terms of the sensitivity of fund's capital allocation to the *home uncertainty.* The home-bias channel is motivated by a large strand of literature, starting from French and Poterba (1991) which documents "home bias" in international capital allocations. If due to informational advantage (Coval and Moskowitz (1999),

[2]We can not absorb *destination* $\times$ *time* fixed effects, as our treatment is at the destination level.

Grinblatt and Keloharju (2001)), home-bias impacts the flow-EPU relationship, we would expect that funds react less negatively to the home-uncertainty compared to the foreign uncertainty. Interacting EPU with the dummy for home destination on RHS, we document that funds withdraw less capital in response to a home uncertainty shock (relative to foreign uncertainty shocks) on average. At first, this is supportive of the home-bias for uncertainty shocks. However, a deeper examination reveals that this home-bias in flow-uncertainty sensitivity is primarily driven by the G7 destinations including the USA. For less advanced and emerging economies, we find weaker home bias; both economically and statistically.

Motivated by the fact that home-bias shows up only for the destinations which are typically seen as safe-havens, we examine whether the "flight-to-safety" (Longstaff (2004), Beber, Brandt, and Kavajecz (2009), Adrian, Crump, and Vogt (2019)) is impacting fund's investment decisions in response to EPU. To disentangle the two channels, we estimate the flow-EPU sensitivity of the foreign funds not domiciled in the G7 nations (such as Brazil) to the EPU shocks within G7 nations. Consistent with flight-to-safety, we find that relative to other destinations, capital flows, even by foreign funds into the USA and other G7 countries, are less sensitive to the EPU shocks in these G7 countries. In fact, we find that foreign funds *increase* capital flows to G7 destinations after a spike in EPU of these nations (relative to other destinations not affected by the EPU shocks). However, a spike in the EPU at a non-G7 destination triggers capital outflows by global funds from that location. Overall, our evidence suggests that the lower flow-EPU sensitivity documented for the G7 destinations is primarily explained by the "flight-to-safety" than the "home-bias".

We next examine the cross-country heterogeneity in the flow-EPU relationship based on (a) information transparency and institutional strength of a destination, and (b) cultural similarity and geopolitical alignment between a fund's domicile and destination country. Our motivation is based on the prior literature which shows that geographic proximity, cultural ties and familiarity as important determinants of cross-border financial transactions (Starks and Sun (2016), Guiso, Sapienza, and Zingales (2009), Papaioannou (2009)).

First, we explore the role played by the informational transparency for the cross-section of flow-EPU sensitivity. Nagar, Schoenfeld, and Wellman (2019) show that greater management disclosures help partly mitigate the effect of EPU on stock prices. Consistent with our thesis, we find that the negative flow-EPU relationship is weaker for destination countries with high informational transparency. Fuchs and Gehring (2017), Delis, Hasan, and Ongena (2020) document the importance of the institutional and democratic strength for credit markets. We conjecture and confirm in the data that economic uncertainty's adverse impact on fund flows is likely higher in countries with poor judicial protection and less stable governments, using the measures of these characteristics from the International Country Risk Guide (ICRG).

We next turn to the characteristics capturing similarity and familiarity between a fund's domicile and the destination country and study whether variation in the cultural, legal, and political familiarity of destinations with the investor fund's home country explains the cross-sectional variation in the fund's response to EPU. We focus on the U.S. based funds.[3] The underlying idea is that U.S. funds may possess better information regarding culturally, legally, or politically similar countries to the USA, which may help the funds resolve some of the uncertainty.[4] Consistent with this hypothesis, we find no statistically significant flow-EPU relationship for countries with a common language, similar ethnicity, same legal origin, and high geopolitical alignment with the USA. In contrast, there is a statistically significant negative flow-EPU relationship for countries that are culturally or legally different from the U.S. [5]

Can global funds through their response to EPU spikes to a certain country also impact other countries? We answer this question next. We find economically significant spillover effects of a

[3]For this test, we restrict the domicile to the US funds as we do not have all characteristics for fund-destination pairs.

[4]See also Fisman, Paravisini, and Vig (2017).

[5]We classify an investment destination as being culturally similar to the U.S. if it shares a common language or is ethnically similar. These measures are based on Kolo (2012) and Lewis (2009).[6]. To capture legal and political similarities with the U.S., we divide countries into those that do and do not share a common legal origin with the U.S. (Common Law vs. Civil Law countries). Finally, our measure of geopolitical alignment is based on the voting alignment between the U.S. and the investment country at United Nations General Assembly meetings (Bailey, Strezhnev, and Voeten (2017)).

spike in EPU from one country to another through global funds' equity investments in multiple destinations. To this end, we define "leave-one-out" fund-level EPU shock as the weighted average of EPU shocks across the fund's investment destinations, excluding the target country of investment. For instance, if a fund has investment allocations in 15 countries, we leave out one investment destination country and calculate a fund-level EPU exposure coming from the other 14 countries.[7] We find that a fund's exposure to EPU shocks in other countries significantly affects the fund's investment allocation in the particular "left-out" target country. This effect is orthogonal to the negative response to that left-out country's EPU shock. A one standard deviation increase in fund-level exposure to EPU shocks in other destinations has a *two times* larger negative effect on a fund's investment in a specific "left-out" target country than the negative response to that target country's own EPU shock. Further more, the negative response ot the EPU spike of the "left-out" country amplifies due to fund-level exposure to EPU shocks elsewhere. We conclude that global funds can have large adverse spillover effects through their portfolio responses.

To better identify global ownership in multiple destinations as a channel for transmission of EPU shock, we conduct a more detailed stock-level transmission tests in spirit similar to Morelli, Ottonello, and Perez (2022). We document substantial negative pricing effect on the US stocks whose global institutional owners are more exposed to *ex-USA* EPU shocks. In particular, a unit standard deviation higher ex-USA EPU exposure predicts a 3.58% lower four-factor risk-adjusted returns. These results are robust to including stock fixed effects as well alleviating the concern that stocks held by global investors are fundamentally different or could be fundamentally more exposed to the international shocks.

We also highlight the role of the "re-allocation" mechanism in transmission of these external EPU shocks onto the US stock prices. In particular, we document that the transmission is strong even in the absence of "fire-sale" mechanism of Coval and Stafford (2007), JOTIKASTHIRA, LUNDBLAD, and RAMADORAI (2012). That is even when funds do not face any capital re-

[7] See 4.3.1 for the details regarding the construction of fund-level EPU exposure measure.

demptions, mere internal re-allocation in the wake of EPU shocks it faces has serious pricing implications for the US stocks.

Our results complement the prior literature that highlights the role of financial lending institutions in the propagation of economic shocks across countries. Specifically, Morelli, Ottonello, and Perez (2022) documents that the emerging market corporate bonds held by the US investment banks which suffered more equity valuation loss in the aftermath of the Lehman crises suffered more price drop. Compared to that evidence, our paper doucments transmission of local EPU shocks emanating outside the US on to the US stock price *via* the global funds ownership. De Haas and Van Horen (2012) show that, following the Lehman Brothers default, banks that wrote down subprime assets transmitted these shocks across borders by curtailing their lending abroad. Similarly, using the 2008 financial crisis as their laboratory setting, Cetorelli and Goldberg (2011) highlight the propagation of adverse liquidity shocks on developed-country banking systems to emerging markets across Europe, Asia, and Latin America through the lending channel. In contrast, to the best of our knowledge, we are the first to document that institutional funds may also propagate uncertainty-related shocks through their global equity investments.

Finally, we examine whether global shocks to funding liquidity affect a fund's response to economic policy uncertainty. We use the 2013 US Fed taper tantrum episode as a shock to the availability of capital. Many emerging economies experienced a significant capital exodus following the announcement on 22 May 2013 that the US Federal Reserve might begin tapering down the bond purchases (López-Villavicencio and Pourroy (2021)). For instance, prior literature shows that lending flow to emerging markets contracted following the tapering episode (Avdjiev and Takáts (2014)). In contrast, we examine whether the taper tantrum episode exacerbated equity capital outflows from destinations with high pre-taper and post-taper EPU. We find that funds withdraw more capital from destinations with high Pre-Taper/Post-Taper EPU following the Taper tantrum. This is in addition to their reaction to the contemporaneous destination EPU. Specifically, the negative association between destination EPU and fund flows doubles in magnitude post-Taper.

In the last section, we test whether funds managing their EPU exposure proactively outperform those funds which do not shy away from EPU exposure. Estimating fund's performance using a *global* Fama-French factor model, and measure of covariance between fund-destination flows and destination EPU to proxy for fund's aversion to EPU, we document a negative relation between the two. Funds more averse to EPU as reflected in the fund-flows outperform the other funds. The relationship is economically modest with a unit increase in our preferred covariance measure resulting in a 22 basis points reduction in fund's alpha over next quarter in annual terms.

Our results are robust to alternate measures of funds capital allocation decisions. First, along the extensive margin, we find that a rise in destination EPU increases (decreases) the likelihood of funds exit (entry) from (into) the target country. Second, our results hold if we use "destination-weight" in a fund's portfolio as a dependent variable instead of capital flows.

Finally, our results are not explained by financial market uncertainty, measured using implied stock market volatility (VIX). In particular, a skeptic may be concerned that EPU may be correlated with VIX. To that extent, our findings may capture fund response to stock market volatility rather than economic uncertainty. First, we document substantial cross-country heterogeneity in the correlation between EPU and VIX. Japan, Australia, and Emerging countries like India and Mexico exhibit a positive correlation between VIX and EPU. In contrast, China, the UK, and Russia have a strong negative relationship between VIX and EPU. Second, the negative flow-EPU relationship holds after controlling for the destination countries' VIX.

Overall, ours is the first study to comprehensively examine the role of economic policy uncertainty in the cross-country equity allocations of global institutional funds.

2 Related Literature and Contribution

In the seminal work, Baker, Bloom, and Davis (2016) develop country-level economic policy uncertainty measures (EPU). Baker, Bloom, and Davis (2016) show that the EPU measure is associated with greater stock price volatility and other real outcomes, such as reduced investment and employment in many industries. In related work on uncertainty, Bloom, Floetotto, Jaimovich, Saporta-Eksten, and Terry (2018) show that uncertainty spikes during recessions resulting in a drop in gross domestic product. The EPU measure in Baker, Bloom, and Davis (2016) has been subsequently used by many studies which document the real and financial effects of policy uncertainty. Overall, prior studies on effects of uncertainty document that increase in policy uncertainty is associated with lower corporate investments (Gulen and Ion (2016), Jens (2017), Alok and Ayyagari (2020)), less IPO activity (Çolak, Durnev, and Qian (2017)), fewer M&A transactions (Bonaime, Gulen, and Ion (2018), Nguyen and Phan (2017)). Similarly, using elections as a source of political uncertainty, Cao, Li, and Liu (2019) show that elections in a country are associated with fewer inbound acquisitions and an increase in outbound cross-border acquisitions by the country's firms. In contrast, our paper investigates the effect of EPU on cross-border fund flows.

Further, with regards to financial markets, extant studies show that uncertainty is associated with lower stock prices (Pastor and Veronesi (2012), Pástor and Veronesi (2013)), reduced stock market liquidity (Nagar, Schoenfeld, and Wellman (2019)), increased stock return volatility (Boutchkova, Doshi, Durnev, and Molchanov (2012), Pástor and Veronesi (2013)) and lower stock market participation by retail investors (Agarwal, Aslan, Huang, and Ren (2020, forthcoming)). Importantly, Kelly, Pástor, and Veronesi (2016) predict that uncertainty may spill over across countries and that these effects should be stronger when investors face greater information asymmetry. Consistent with these predictions, we document the role of information asymmetry. We find that the negative flow-EPU relationship manifests primarily for countries with low levels of informational transparency. Along similar lines, the negative flow-uncertainty relationship is mitigated by cultural, legal, and geopolitical proximity between the home country of a fund and the investee country. Finally, the flow-uncertainty relationship is weaker for countries with stable governments and better legal and government/political institutions.

Our study is also related to an emerging and important strand of literature focusing on the determinants of cross-country capital flows (Maggiori, Neiman, and Schreger (2020), Coppola, Maggiori, Neiman, and Schreger (2021)). Maggiori, Neiman, and Schreger (2020) show that the currency denomination of debt assets is a significant determinant of global debt portfolios. Specifically, bond portfolios exhibit strong home-currency bias as they disproportionately invest in bonds denominated in their own country's currency. Consequently, we control for the exchange rate in all our tests. Kempf, Luo, Schäfer, and Tsoutsoura (2022) show that political alignment with foreign governments affects the cross-border capital allocation by U.S. institutional investors. Our work complements this literature and highlights the role of EPU in cross-border equity flows by global mutual funds.

Finally, our study speaks to the role of financial intermediaries in transmitting economic uncertainty-induced financial shocks across countries. Existing studies in this area document that lending institutions propagated the financial crisis across borders by curtailing their lending abroad in the aftermath of the financial crisis (Cetorelli and Goldberg (2011), De Haas and Van Horen (2012)). In contrast, we document that fund flows may also transmit policy uncertainty-related financial shocks across countries. To the best of our knowledge, we are the first to document the role of equity capital in the propagation of financial shocks across borders.

3 Data

We obtain the institutional global portfolio holdings data at quarterly frequency from Thomson Reuters Global Ownership database. The EPU data is publicly available from the webpage maintained by Baker, Bloom, and Davis (2016)[8] and covers 28 countries at monthly frequency

[8]See https://www.policyuncertainty.com/

(Table 1). We collect additional country-level macro and financial variables from IMF and World Bank websites.

We focus on the active equity-focused institutions across 77 host-countries and track their investments across 21 countries for which EPU data is available between 1998-2019. In particular, we include only common stock holdings of these managers. We also restrict the attention to Mutual Funds, Hedge Funds and Investment Advisors.[9] We require that funds maintain at least 50% of its total assets internationally on average within the data to focus on the funds with global mandate. The unit of observation is Institution×Destination×Quarter. We drop any institution-quarter where asset size is below $10Mn and further drop institution-destination-quarters where destination-assets of that institution are below $5Mn. We also exclude the institutions which do not survive for at least five years in the sample. Out final sample consists of 18,131 institutions with 22,59,412 Institution×Destination×Quarter observations. Top 5 host-countries namely UK (2653), Spain (2318), Germany (1418), US (1405), and Switzerland (1390) account for 50% of the institutions while top-10 host-countries account for 70% of the institutions in our data. Mutual funds constitute 87% of the institutions.

The main variable capturing the capital movement is defined at the Institution-Destination-Quarter level similar to mutual fund flow literature as follows

$$flow_{fct} = \frac{assets_{fct} - (1 + r_{ct})\, assets_{fct-1}}{(1 + r_{ct})\, assets_{fct-1}} \tag{1}$$

where $assets_{fct}$ denotes the dollar value of investments of fund f in destination country c at the end of quarter t, and r_{ct} denotes the destination country equity returns for quarter t.[10] The Economic Policy Uncertainty (EPU) index is standardized within each country.

[9]These are respectively given by OwnTypeCode 401, 106/113 and 107/113 in the Thomson Global Ownership Database.

[10]We approximate the institution's return within a country by country equity return due to lack of security level return data. The stock return data is not available for a number of stocks, especially those from the emerging markets. In robustness tests in Section 4.4, we use the subsample where stock return data is available to calculate flows. We find very similar results. The details are in Section 4.4.

3.1 Measuring Local EPU

Our focus in this paper is on studying the response of institutional investors to the "local" economic policy uncertainty shocks. To this end, we extract EPU shocks as follows

$$\log(EPU)_{ct} = a + \gamma_1 . \log(EPU)_{world,t} + \gamma_2 \log(EPU)_{ct-1} + \varepsilon_{ct} \tag{2}$$

Our model orthogonalizes the EPU in county c with respect to the World EPU to capture the "local" component of the EPU. This adjustment is important as the first principal component of the EPU across 27 nations explains 75% of the joint movement. To extract the unpredictable component, we include additionally include AR-term. Our measure of "Local EPU Shocks" is given by ε_{ct} from the above model. The residuals obtained from this model(or our local shocks) are serial uncorrelated.

3.2 Summary

Table 2 provides more description of the data and underlying variables. There are two main restrictions that we apply in selecting our sample. The first one is that we restrict our sample to 21 destination countries for which EPU data is available. The second is to focus on funds having global mandate, we require that on average, at least 50% of the institution's assets are invested internationally. Before placing the restriction on the minimum international exposure, our data has 34,352 institutions or funds. Out of which 18,131 satisfy the international exposure criterion. Out of these, 15,953 (about 88%) are mutual funds, 1573 (8.67%) are investment advisors, 179 (about 1%) are hedge funds and 426 (2.35%) institutions are either hedge funds or investment advisors.

A median fund has 82% of the its global assets invested in the 21 destination countries that we consider. In this sense, our sample is not restrictive and covers the substantial part of a fund's portfolio. Even the 25^{th} percentile of the asset coverage is 71%. Data also indicates a good geographical diversification of portfolio. A median fund seems well diversified with exposure to 10 countries and average home weight of 11.44%. A median destination weight of 8.34% and an average destination weight of 17.85% suggests large concentration in favored investment destinations.

A median fund in our sample has assets under management (AUM) of $600.8 Million across 21-destination countries. As expected, US domiciled funds are large with median size of $1319.4 Million, followed by funds domiciled in the advanced countries with median assets of $535.3 Million, and further followed by funds domiciled in the non-advanced countries with median assets of $211.5 Million. Our main variable of interest is the fund-destination flow as defined in the equation 1. The distribution is fat tailed on the right side. Median fund-destination-quarter flow is 1.39% with inter-quartile rage of -13.27% to +31.79%.

Table 3 provides cross-country correlation of Economic Policy Uncertainty (EPU) index. For the subset of advanced economies, EPU is highly correlated with each other (Column 1), with the US (Column 2), and with the World (Column 3) as evidenced in Panel A. The average of correlations with the US and the World EPU is 0.65 and 0.67 respectively. On the other hand, EPU across emerging economies seem to be only modestly correlated with the US EPU with the average correlation of 0.38. More striking is the fact that EPU is even less correlated for emerging economies within the group (Column 6). For example, for India and Mexico the average correlation of EPU with other emerging economies is merely 0.16 and 0.01, respectively. This provides us with country-level variation in the EPU, especially for the emerging economies that we exploit to trace the impact of EPU on the portfolio allocation by the investment houses. The EPU shocks extracted using equation 2 is even less.

4 Results

This section presents our results. We first examine the flow-EFU relationship for global funds and the economic channels that help explain the variation in the relationship. We show that there exists cross-country heterogeneity and document that global funds can transmit EPU shocks through global asset allocations. Finally, we stress test the flow-EPU relationship through several robustness tests.

4.1 EPU and Global Fund Flows (Baseline)

We begin by examining the effect of economic policy uncertainty on global institutional capital flows. Table 4 shows our main result. The dependent variable is fund-destination-quarter flows in quarter t as defined in equation 1. The main variable of interest is lagged EPU index for the destination country c. We standardize the EPU within each destination country for ease of interpretation.[11]

The reported coefficient estimates are from the variations of the following regression specification:

$$Flow_{fct} = \beta_1 EPU_{c,t-1} + \beta_2 X_{ct} + \alpha_{ft} + \mu_c + \epsilon_{fct} \tag{3}$$

where $EPU_{c,t-1}$ represents destination country EPU at time $t-1$, X_{ct} is a vector of controls related to the destination country, α_{ft} captures $fund \times time$ fixed effect, and μ_c captures destination country fixed effect. Using destination fixed effects ensures that our estimates are identified through variation in economic policy uncertainty within the destination country. Further, a novel feature of our data is that we observe the portfolio flows for a given fund across multiple investment destinations in any period. This is in contrast to the vast literature focusing on fund portfolios within a single country. This allows us to control for time-varying shocks at the fund

[11] This is innocuous as we absorb destination country fixed effects in each of our specification.

level in a non-parametric way by using $fund \times time$ fixed effects. Specifically, any fund-level time trends driven by fund-level liquidity pressure (redemption/subscription), changes to investment mandates, or changes in the fund manager's risk-aversion cannot confound our estimates. Thus in our preferred specification, we control for both *destination* and $fund \times time$ fixed effects. We cluster standard errors at the fund level.

Focusing on column 1 of Table 4, we find that a one standard deviation increase in a destination country's EPU is associated with an approximately 0.5% (2%) decrease in quarterly (annual) fund inflows into that country. The coefficient on EPU is statistically significant at 1% level. In column 2, we find that our results hold after controlling for a host of time-varying controls at the destination level. In particular, we control for lagged industrial production growth, lagged exchange rate appreciation relative to the US Dollar, interest rates in the investment destination country relative to the US rates, and finally, the equity returns of the main stock market index in the investment destination. Importantly, the coefficient estimates are economically larger after controlling for destination-level time-varying factors. Specifically, we find that a one standard deviation increase in lagged EPU of a destination country is associated with 1.27% (5%) decrease in quarterly (annualized) fund flows from that country.[12]

In column 3, our result remains robust to controlling for $fund \times destination$ pair fixed effects. These fixed effects account for any time-invariant heterogeneity in fund-flows into a destination country, such as fund's destination-specific expertise, geographic familiarity, cultural linkages, or trust. This is important because the literature on determinants of cross-border investments shows that such time-invariant factors are strongly correlated with cross-border financial linkages (e.g., Guiso, Sapienza, and Zingales (2009), Papaioannou (2009)).

Finally, given that a large number of papers in the literature focus on the US domiciled funds, in columns 4 and 5, we re-estimate equation 3 on the sub-sample of funds domiciled inside and outside the USA, respectively, to examine if the non-USA domiciled funds respond differently to

[12] The results are also robust to the clustering at the fund and the time level.

economic uncertainty. We find that both USA and non-USA domiciled funds withdraw capital from a target country in response to a rise in the destination country's EPU.

Overall, these results show that global institutional funds reduce their investments in a target country in response to an increase in economic policy uncertainty.

4.2 Economic Channels

What economic channels can possibly explain the variation in negative flow-EPU relationship at the global level? We tackle this question now. We examine the "home-bias" channel. Prior literature documents the prevalence of home-bias in international portfolio allocation (French and Poterba (1991), Chan, Covrig, and Ng (2005a), Hau and Rey (2008)). Better information regarding the home country of a fund may influence the flow-EPU relationship. The second channel we examine is "flight-to-safety." Global funds may rebalance their portfolios in response to increased policy uncertainty and seek safer destinations (Longstaff (2004), Beber, Brandt, and Kavajecz (2009), Adrian, Crump, and Vogt (2019)). We first examine the role of "home-bias" in flow-EPU relationship.

4.2.1 Home Bias

We test for the presence of home-bias in Table 5. Formally, the reported coefficient estimates are from the following regression specification:

$$Flow_{fct} = \beta_1 EPU_{c,t-1} + \beta_2 Home + \beta_3 Home \times EPU_{c,t-1} + \beta_4 X_{ct} + \alpha_{ft} + \mu_c + \epsilon_{fct} \tag{4}$$

In all specifications, we absorb $fund \times time$ fixed effect (α_{ft}) and destination country fixed effect (μ_c). First, focusing on column 1, we note that one standard deviation increase in a destination country's EPU is associated with a 1.5% decrease in capital inflows. Second, the positive and statistically significant coefficient (β_2) on *Home* is consistent with the home bias in portfolio allocations documented in the prior literature.

However, the coefficient of interest is β_3, which captures a fund's differential response to an increase in EPU in their home country relative to other countries. Consistent with the thesis of "informational advantage," the positive and statistically significant coefficient estimate of β_3 suggests that funds withdraw less capital from their home country in response to a one standard deviation rise in the home country's EPU. However, the sum of the coefficients ($\beta_1 + \beta_3 = 2\%$), which captures the overall response to a rise in the home country's EPU, is statistically significant at 1% level. Specifically, on average, a one standard deviation increase in the home country's EPU is associated with an approximately 2% (8%) *increase* in quarterly (annual) fund inflows.

In column 2, we restrict the attention to the funds domiciled in G7 countries, and find similar results as in column 1. That is, there appears to be a home-bias in flow-EPU sensitivity relationship. We further split the sample of G7 destinations into the USA and other G7 nations and find the home-bias for both the set of destinations, albeit more strongly for the USA. In particular, for the USA, the interaction of EPU and the home dummy is positive, economically large and statistically significant (column 3).

Column 4 shows results for other G7 destinations. We find that while β_3 is economically large, it is statistically not different than zero. The net response of fund flows to home-EPU as measured by $\beta_1 + \beta_3 = 1.13\%$ is statistically indistinguishable from zero for these remaining G7 countries, again indicating that funds domiciled in G7 ex-USA countries do not withdraw capital in response to their home EPU.

Lastly, we test the home-bias on the set of non-G7 destinations in column 5. The home-bias as measured by the interaction of EPU and the home dummy is positive, but economically smaller in magnitude and statistically insignificant. Nonetheless, $\beta_1 + \beta_3 = -1.08\%$ is statistically indistinguishable from zero, indicating "home-bias", albeit a weaker one quantitatively. In summary, we find presence of home-bias for the flow-EPU sensitivity. However, though these effects are present everywhere, they are weak for the non-G7 nations compared to G7 destinations, and strongest for the US.

4.2.2 Flight to Safety

Our results above indicate that "home-bias" in flow-EPU sensitivity is prominent exactly in the destinations where "flight-to-safety" channel is likely to be prominent as well (such as the US). Flight-to-safety channel seems inconsistent with the "informational advantage" view of home-bias. Suppose access to better information regarding the home country partially reduces the impact of uncertainty. In that case, we should observe that funds domiciled in *any* country (including non-G7) should react less to a rise in home country EPU. Rather, we observe this effect primarily for the US and G7 domiciled funds. Therefore, the home-bias may potentially be capturing the flight-to-safety effect.

To better disentangle the "flight-to-safety" channel from "home-bias", we examine if the funds domiciled "outside the G7 countries" (such as in China or Spain) react differently to a rise in EPU in G7 destination countries (such as the US) as compared to a rise in EPU in non-G7 destinations (such as Brazil). Hence, in these tests, we restrict the sample to fund-destination pairs where the destination is not the fund's home country. Table 6 report the results.

We first focus on the US. The role of the US markets in supplying safe assets and thereby attracting foreign capital flows during times of economic distress is well-known. For example, Bertaut and DeMarco (2009) document a spike in net purchases of US treasury securities by foreign investors following Lehman's bankruptcy. This was a result of foreign investors re-balancing their portfolios away from riskier equities to safer treasury securities. In contrast, our focus here is on examining non-US funds' equity portfolio allocations in response to the rise in US policy uncertainty.

Column 1 of Table 6 report the results. First, we note that, on average, funds reduce capital flows by 1.7% in response to a one standard deviation spike in destination-EPU. However, consistent with "flight-to-safety", focusing on the coefficient on the interaction between EPU and the dummy identifying the USA as a destination, we find that capital flows are relatively higher (1.9%) in response to a rise in US EPU compared to other destinations. This result is important relative to the literature because it indicates that even funds domiciled outside the USA do not actively liquidate their riskier equity allocation in the US in response to an increase in the US policy uncertainty.[13]

In column 2, we examine whether the "flight-to-safety" documented above is specific to the USA or observed for other G7 economies as well. In these tests, in addition to excluding pairs of funds-destinations where the destination is home, we also exclude all observations where the destination is the US so that US is not in the control group of destinations.[14] The negative coefficient on EPU (-2.46) is substantially larger in magnitude relative to the baseline coefficient (-1.27) reported in column 1. This indicates that investors are more averse to policy uncertainty within non-US and non-G7 destinations. Focusing on the interaction term, we again find that funds react less to a rise in EPU in non-US G7 countries, suggesting that funds perceive such nations as less risky during times of heightened economic uncertainty.

Finally, we estimate an interactive model including the full sample of "non-home" fund-destinations pairs and confirm the above documented flight-to-safety effects. In column 3, the interaction between EPU and the dummy for G7 destination has a large positive and significant coefficient, confirming that for foreign funds, the flow-EPU sensitivity is lower for G7 destinations. In column 4, we split the response over the USA and the other G7 destinations and obtain the same flight-to-safety effect for both the USA and the other G7 nations.

[13]Recall that median equity share of the portfolio in our sample is 93%.

[14]Else we will be underestimating the flight-to-safety of other G7 destinations as we would be comparing it against the US as a destination.

Column 5 of the table conducts our sharpest test; we run a horse race between the two channels. To this end, we include the triple interaction between the EPU, G7 destinations dummy, and the home dummy allowing for both channels to play their role. Note that now the sample includes "all pairs", whether home or non-home. We find that the lagged EPU has a coefficient of -2.64% confirming the baseline negative relationship between the EPU and the flows. Coming to the interaction terms, first, the interaction between EPU and home dummy (1.71) though statistically insignificant, is economically large. In particular, we can not reject that $\beta\,(EPU) + \beta\,(EPU \times \text{Home}) = 0$ at any reasonable confidence level. This confirms the presence of home-bias as documented earlier, though these effects are quantitatively moderate.

Second, the interaction between EPU and G7 destination is positive with a coefficient of 3.26%, indicating that "all funds", whether domiciled in G7 nations or other nations, have lower flow-EPU sensitivity to the G7 EPU shocks, confirming the "flight-to-safety" channel. Third, and most importantly, the triple interaction between EPU, G7 destinations, and home dummy is statistically insignificant and economically small. This means that the lower flow-EPU sensitivity documented for G7 EPU shocks is driven by 'all global investors" and not only by the home investors. Overall, we find both "home-bias" and "flight-to-safety" channels impact flow-EPU sensitivity. But the evidence is slightly stronger in favor of the flight-to-safety channel.[15]

Prior literature underscores geographic proximity, cultural ties and familiarity as important determinants of cross-border financial transactions (See Starks and Sun (2016), Guiso, Sapienza, and Zingales (2009), Papaioannou (2009)). Motivated by this literature, we next study whether a fund's response to a rise in a destination's EPU varies based on the nature of the destination country, such as information/familiarity regarding the destination, and strength of institutional in the destination country.

[15]A comment is in order on why G7/US enjoy may "safe-haven" status. Rise in economic uncertainty in the US/G7 countries correlates with periods of heightened global uncertainty. The correlation between the US and world EPU is 0.79. Similarly, the correlation between G7 (ex-US) EPU with global EPU is 0.72. Hence, during the times when US/G7 EPU spikes, money managers may face "TINA" or "There Is No Alternative" problem in terms of finding relatively safer destinations to invest.

4.2.3 Information Transparency and Institutional Strength

The quality of information available regarding a destination country may help partly resolve the uncertainty. Thus, funds may react less negatively to EPU in a country with greater informational transparency. We test this hypothesis. To proxy for informational transparency we rely on the index developed by Williams (2015) which captures the quantum and quality of information released by countries.[16] In columns 1 and 2 of Table 7, we examine the flow-EPU relationship for countries with above (high) and below (low) the median value of informational transparency. Consistent with our thesis, we find that the negative flow-EPU relationship is weaker for destination countries with high informational transparency. Specifically, a one standard deviation increase in EPU is associated with 0.21% (2.39%) lower fund flows in countries with high (low) informational transparency.

Next, we examine whether legal and political institutions' quality matters for the fund response to destination EPU.[17] We conjecture that the adverse impact of uncertainty is likely to be higher in countries with poor judicial protection and less democratic governments. We obtain measures of the strength of legal institutions and the strength of democracy from the International Country Risk Guide (ICRG). In columns 3 and 4 of Table 7, we split the sample into countries with above and below median values on the strength of the legal system based on the 6-point scale provided by the ICRG. Columns 5 and 6 focus on the strength of democracy. ICRG rates the strength of democracy based on a 12-point scale. Based on our results on columns 3-6, we conclude that the negative flow-EPU relationship is prominent for the destination countries that have poorer quality legal institutions, and low democratic strength.

Overall, our findings suggest that funds respond less negatively to a rise in foreign countries' EPU for countries with better legal and government/political institutions and higher informational transparency.

[16] This index has been used in prior studies (e.g., Fuchs and Gehring (2017), Delis, Hasan, and Ongena (2020)).

[17] Fuchs and Gehring (2017), Delis, Hasan, and Ongena (2020)) document the importance of these institutions for credit markets.

4.2.4 Cultural Similarity and Geopolitical Alignment

In this section, we investigate whether the response of funds to a destination country's EPU varies with the extent of cultural similarity and geopolitical alignment between the home and the destination country. The underlying idea is that funds may possess better information regarding culturally or politically similar countries to the home country, which may help the funds resolve some of the uncertainty. For these tests, we restrict ourselves to the US-domiciled funds because the proxies for cultural similarity and geopolitical alignment are relatively easier to measure for the US.

Our first measure for the cultural similarity is based on whether the country of the fund investment shares a common language with the USA (Chan, Covrig, and Ng (2005b), Fuchs and Gehring (2017)). In columns 1 (2) of Table 8, we repeat our baseline tests for the sub-sample of countries that share (don't share) a common language with the USA.

Second, we use ethnic-racial similarity and ethnic-linguistic similarity based on Kolo (2012) (see also, Guiso, Sapienza, and Zingales (2009) and Fuchs and Gehring (2017)). The ethnic similarity is based on genealogical similarities and derived from species' biological taxonomy, which captures race, skin pigmentation, and ethnic origin. We define countries with the above (below) median value of ethnic similarity with the USA as similar (dissimilar) and repeat our baselines tests in columns 3 and 4 of Table 8. Kolo (2012) also creates a measure of linguistic similarity, which measures linguistic differences based on language trees from the Ethnologue project.[18]

Our third measure is based on legal origin. Based on this measure, all countries with common law origin are classified as being similar to the USA. In column 5 (6), we re-estimate the baseline regression specification for a sub-sample of countries with the same (different) legal origin as the USA.

[18] Ethnologue project classifies 6,656 languages into different families (Lewis (2009)).

Finally, we measure geopolitical alignment based on the voting alignment between the USA and the investment country at United Nations General Assembly (Bailey, Strezhnev, and Voeten (2017)). The measure is defined as the share of votes in which the home country and the foreign country exhibit the same voting behavior, that is, both voting yes, voting no, or abstaining. In columns 7 and 8 of Table 8, we repeat our baseline tests for the sample of countries above and below the median value of UNGA voting alignment, respectively.

We find no statistically significant flow-EPU relationship for countries with a common language, similar ethnicity, same legal origin, and high geopolitical alignment with the USA. In contrast, there is a statistically significant flow-EPU relationship for countries that are culturally or legally different from the US. These results suggest that cultural similarity with the target country of the investment may mitigate some of the flow-related adverse effects of economic policy uncertainty. Consistent with our results in Section 4.2.3, we find that the negative flow-EPU relationship is weaker for countries with informational transparency.

4.3 Propagation of Financial Shocks

Prior literature shows that financial shocks can be transmitted across countries by financial institutions. For instance, the financial crisis of 2008-2010 brought the role of financial lending institutions in the propagation of economic shocks across countries. De Haas and Van Horen (2012) show that following the Lehman Brother's collapse in the US, banks which had to write down sub-prime assets transmitted these shocks across borders by curtailing their lending abroad. Similarly, using the 2008 financial crisis as their laboratory setting, Cetorelli and Goldberg (2011) highlight the propagation of adverse liquidity shocks on developed-country banking systems to emerging markets across Europe, Asia, and Latin America through the lending channel.

Related to the above literature, we examine in our setting, whether global equity-oriented funds – (a) propagate economic policy uncertainty-related shocks across countries (b) exacerbate the effects of adverse liquidity shocks through their portfolio holdings and c) affect asset pricing in destinations not experiencing the uncertainty shocks

4.3.1 Transmission of EPU Shocks through Global Fund Portfolios

We study whether institutional investors propagate uncertainty shocks through their global equity investments. To this end, we define "leave-one-out" fund-country level EPU shock as the weighted average of EPU shocks across the fund's investment destination except for the target country of investment. Formally, we compute the fund-country EPU shock as

$$\text{FundEPU}_{f/c,t} = \sum_{c' \in \mathcal{C}_{ft}, c' \neq c} \frac{assets_{fc',t}}{assets_{f/c,t-1}} \times EPU_{c',t} \tag{5}$$

where f is the fund, c and c' indexes the country, $\mathcal{C}_{ft}$ is the set of all the target countries in which fund f has investments at the end of time t, $assets_{fc',t}$ is the value of total investments by a fund f in a country c' at time t and $assets_{f/c,t}$ is the value of total assets under management by fund f at time t in destinations excepting c. Then, we estimate the impact of fund's EPU exposure coming from other destinations on to the investments in the target country under consideration using the following regression specification:

$$Flow_{fct} = \beta_0 + \beta_1 EPU_{c,t-1} + \beta_2 \text{FundEPU}_{f/c,t} + \beta_4 X_{ct} + \alpha ft + \mu_c + \epsilon_{fct} \tag{6}$$

Table 9 reports the results. Column 1 shows that funds' exposure to EPU shocks in other destinations significantly affects the fund's investment decision in the destination country. This effect is above the negative response to that destination's EPU shock. A one standard deviation increase in fund-level exposure to EPU shocks in other destinations has a two times larger negative effect on a fund's investment in a specific target country than the negative response to that country's own EPU shock (coefficient of -3.86 on the fund's "leave-one-out" EPU relative to a coefficient -1.84 on the destination EPU).

In column 2, we investigate if the fund's exposure to EPU through other portfolio countries ("leave-one-out" EPU) exacerbates its response to EPU in the target country. To this end, we interact with a dummy that identifies fund-country-quarters where the fund's exposure to EPU shocks in other countries is high (Fund-EPU > 0) with the destination EPU. We find that the negative response of fund-flows to the destination-EPU is concentrated within the set of funds facing higher exposure to uncertainty through their investments in other destinations. In particular, in response to a one standard deviation increase in a destination country's EPU, funds facing higher EPU through their other investment destinations withdraw 2.5% (10%) more flows on quarterly (annualized) basis compared to the funds facing less severe uncertainty shocks elsewhere. Therefore, a fund's reaction to a destination's EPU is conditional on its overall exposure to EPU at the portfolio level.

In columns 3 and 4, we find that these results are robust to controlling for fund $\times$ destination as well as destination $\times$ time fixed effects. These results show that within a given (destination, time) pair, if one sorts the funds based on the fund's (ex-destination) EPU exposure, then the funds with larger fund-level EPU react more to the destination-specific EPU.

Finally, building on our findings on heterogeneous response to uncertainty discussed in Section 4.2, we investigate whether such spillovers are relatively muted for G7 nations. We find that for G7 countries, the fund's capital allocation in a G7 destination is affected less by the fund's (ex-destination) EPU exposure in other destinations.

In summary, these results highlight the potential spillovers of a country's EPU related flow-shocks to other countries through global funds. We document economically significant spillover flow effects of a spike in EPU from one country to another through global funds' equity investments in multiple destinations.

4.3.2 Transmission of EPU Shock and Stock Returns

The previous result documents how a global fund alters its allocation in geographies unaffected by EPU shocks in response to its EPU exposure elsewhere. In this section on the other hand, we study whether global funds becomes conduit through which EPU shocks transmits to the asset prices internationally. We document supporting evidence on the sample of US stocks.

We construct our stock-level transmission test on the US stocks in spirit of Morelli, Ottonello, and Perez (2022). That paper documents that emerging market corporate bonds owned by the US investment banks *ex-ante*, which suffered more equity valuation loss in the aftermath of Lehman crises, experienced more severe price drop. Similarly, we construct a stock-level measure of *ex-USA* EPU exposure *via* ownership of that stock by the global funds exposed to the EPU shocks elsewhere. In particular, for the US stock s, the Stock's ex-USA EPU exposure is measured as

$$\text{Stock-EPU (Ex-USA)}_{st} = \sum_{f} W_{sft} \times \text{Fund-EPU (ex-USA)}_{ft} \tag{7}$$

where W_{sft} is the fraction of the stock s's market capitalization owned by the fund f at the end of quarter t and Fund-EPU (ex-USA)_{ft} is the ex-US EPU (standardized) exposure of fund f calculated as the $\text{FundEPU}_{f/c=US,t}$ as defined in equation 5.[19] Intuitively Stock-EPU (Ex-USA) in equation 7 captures the exposure of stock s to the EPU shocks outside the USA, through its shareholders who are invested internationally. In other words, our measure of stock-EPU identifies the global ownership as the channel of transmission of the EPU shocks.

We focus on all the US stocks with market capitalization greater than 5 Mn\$ at the start of the quarter in which we measure the stock returns. This leaves us with a set of 13,519 stocks. The mean Stock-EPU (Ex-USA) is 0.06 (in standardized units of country EPU), with a wide

[19] In particular, the Fund-EPU (Ex-USA) is defined as

$$\text{Fund-EPU (ex-USA)}_{ft} = \sum_{c' \in \mathcal{C}_{ft}, c' \neq US} \frac{assets_{fc',t}}{assets_{f/US,t-1}} \times EPU_{c',t}$$

inter-quartile range of -0.14 to +0.16 and a significant variation of 0.63.[20] More importantly, our stock-EPU measure is uncorrelated with the aggregate ownership of the stock by the global funds in our sample. This ensures that when we sort the stocks based upon its EPU exposure, we are not implicitly picking up the global ownership of that stock.

We measure the stock's monthly risk-adjusted return (α) using Fama-French & Carhart four factor model. In particular, for a given month t, we estimate stock betas using past 60 months of data,[21] and then estimate month t alpha as the residual of the stock's month t excess return after subtracting the systematic return component using the lagged betas. Then for quarter t, we estimate the *alpha* as the average of monthly alphas in that quarter.

Our transmission test estimates a following model in the quarterly panel of stock alphas

$$\alpha_{st} = \gamma_s + \delta_t + \beta.\text{Stock-EPU (Ex-USA)}_{st-1} + \phi.X_{it-1} + \varepsilon_{st} \tag{8}$$

where γ_s and δ_t denote the stock and time fixed effects respectively, and X are the commonly used control variables in the literature. Following Ang, Hodrick, Xing, and Zhang (2006) and others, we control for the size of the stock (log assets), a proxy for the growth opportunities or Tobin's Q as measured by the Book-to-Market ratio, stock's volatility estimated using past 60 month's of data prior to the start of the quarter, stock momentum captured by the return over the past one quarter, as well as factor betas.[22] Importantly, in our preferred specification we also control for aggregate stock ownership by the global funds in our sample.

In column 1, we begin simply by regressing stock's alpha on the stock's EPU exposure outside the US (Ex-USA) via its global owners and absorb time fixed effects. A one standard deviation increase in stock's EPU exposure (Ex-USA) predicts a 3.58% lower four-factor alpha next quarter in annualized terms. In essence, we find that the US stocks whose owners suffer bouts of economic

[20]Recall that the EPU is expressed in standardized units while computing stock-EPU.
[21]We require minimum 36 month data for the stock to be included in our sample for month t
[22]Controlling for betas additionally in the regression of alpha is standard after Ang, Hodrick, Xing, and Zhang (2006).

policy uncertainty shocks outside the US, experience a significantly lower risk-adjusted returns in the following quarter. This is a strong evidence suggesting how global owners act as a conduit to transmit the external EPU shocks back on to the US stock prices. This evidence is novel in two respects. First, it documents a feedback from other "non-safe haven" countries to the US – a direction of spillover thus far less explored by the literature. Second, our evidence shows that even when the US experiences inflow of capital in the wake of rising global uncertainties, there are significant pricing implications for the US stocks, which have not been well-documented till the date and which capital flows alone fail to capture. In columns 2-4, we progressively add the controls (X) discussed earlier The result becomes extremely strong once we control for these stock characteristics. The coefficient amplifies more than three-times from -2.99% to -9.83%.

In column 5, we document that the US stocks exposed to external EPU shocks (through its global owners) also become more illiquid. A one standard deviation increase in stock's EPU exposure (Ex-USA) increases the stock's Amihud illiqudity by 0.083. This is economically significant a increase in stock's illiquidity with mean and the variation of Amihud Illiquidity in our sample being 0.114 and 0.408 respectively.

4.3.2.1 International Transmission or Fundamental Exposure?

One concern with this test could be that the stocks held by global funds are fundamentally different. For example, stocks held by global funds could be deriving more fraction of their revenues internationally which makes these stocks naturally more vulnerable to the external EPU shocks. To this extent, we may not be identifying the effect of global fund's ownership in transmitting the EPU shocks. We resolve these concerns in multiple ways. First in Column 2, we directly control for fraction of stock's market capitalization owned by the funds in our sample and still obtain a negative annualized risk-adjusted stock return of 2.99% in the following quarter.[23] Second, we

[23]The global ownership of the stock is measured as

$$\text{Global Ownership}_{st} = \sum_{f} W_{sft} \tag{9}$$

absorb stock fixed effects in column 4 to control for the time-invariant unobserved characteristics of the stock (including time-invariant international exposure of the stock's revenue or business stream). We obtain a large and statistically significant coefficient of -2.63 on the stock's Ex-US EPU exposure and validate our result.

Lastly we directly measure the international exposure of the stock using various methods. The results are documented in table 11. In column 1, using Compustat's geographic files we measure the fraction of stock's reported pre-tax income that is foreign. We keep absorbing the stock FE still. Even after controlling for the international income exposure, our coefficients are virtually unaltered. However it could be the case that a firm is exposed to international economic policies despite having very minimal direct revenue stream from international markets, say through it's international suppliers. Hence, we measure the stock's international exposure by quantifying the stock return's dependence on the world stock market. In particular, we obtain Fama-French's developed markets (ex-US) monthly excess returns ($r^e_{Developed,\tau}$) and emerging markets monthly excess returns $r^e_{EM,\tau}$, and estimate a following model over for 60 months ($\tau \in [t-60, t-1]$) prior to the beginning of the quarter t

$$r^e_{x,\tau} = a_{xt} + \gamma.mktrf_\tau + \epsilon_{x\tau} \qquad \text{for } x \in \{developed, EM\} \tag{10}$$

$$r^e_{s\tau} = \alpha_{st} + \beta_{Dev}\epsilon^{`e}_{Developed,\tau} + \beta_{EM}\epsilon^e_{EM,\tau} + \varepsilon_{s\tau} \tag{11}$$

where $r^e_{s\tau}$, and $mktrf_\tau$ denotes the stock's excess return and the Fama-French US excess market return factor respectively. Our measure of stock's international exposure is R^2 from the second or equation 11 in the above model. The first stage orthogonalizes the developed (ex-US) and the EM market return with respect to the US market returns allowing us to measure stock's exposure to the world market returns over and above the correlation of the overall US stock markets with the world markets.

Using this R^2 measure which we label "Stock's World R^2", the coefficient if anything strengthens to -10.25%. The evidence taken together suggests that the results we obtained so far are not capturing the effect on the stock returns due to its fundamental international exposure, but through the global funds owning both the US stocks and the stocks in the regions affected by the EPU shocks. Having said that, we explore if the stock's fundamental exposure to international markets amplify the transmission of EPU shocks. To that end, in Column 3, we interact the Stock's World R^2 measure with the stock's Ex-US EPU exposure. First, stock's Ex-US EPU still matters significantly with a coefficient of -8.60%. However, the coefficient of -10.75% on the interaction is strongly negative and statistically significant suggesting that stock's which are exposed fundamentally to the international markets experience a more negative risk-adjusted returns in response to its global owners facing EPU shocks outside the USA.

Overall, we present a very strong evidence that there are significant pricing effects on the US stocks of the economic policy uncertainty external to the US.

4.3.2.2 Role of Fire Sales Vs. Portfolio Re-Allocation

Having established that the global funds transmits the external EPU shocks on to the prices of the US stocks, we next study the specific channels through which these effects take place. In particular we evaluate the relative role of two channels that can explain these results: First is the "Fire-Sale" mechanism of Coval and Stafford (2007) where funds liquidate the positions in the stocks to satisfy the redemption pressure it is facing from its investors. The second is the "Reallocation" channel where independently of the redemption pressure, funds re-allocate the portfolio to the "preferred destinations" (say Home) causing them to liquidate the positions in the US.

To this end, we measure the redemption pressures the fund is facing in multiple ways including the way Coval and Stafford (2007) measure it. The first is our "Redemption" measure is a average of fund's quarterly capital flows (measured in percentage) aggregated to the stock level using the fund's ownership weights as follows

$$Redemption_{st} = \sum_f w_{sft-1} \times \frac{(assets_{ft} - assets_{ft-1} \times (1 + r_{ft}))}{assets_{ft-1}} \tag{12}$$

where f and s indexes the fund and the stock respectively. Stock s as higher redemption measure if the funds owning it face more redemptions. The second measure we use is similar to the measure of "Pressure" used by Coval and Stafford (2007) and is computed as

$$Pressure_{st} = \sum_f w_{sft-1} \times [\mathbb{1}\,(\text{Bottom 10\% Fund-Flows})_t - \mathbb{1}\,(\text{Top 10\% Fund-Flows})_t] \tag{13}$$

Results are documented in table 12. Column 1 and 2 control for these two measures of stock's redemption in addition to our Ex-US Stock EPU measure. We obtain large and statistically negative coefficients on both the variables. For example in column 2 where we use Coval and Stafford (2007) measure of Stock's redemption pressure, the coefficient on Ex-US Stock EPU is -10.20% and that on the *pressure* variable is -7.68%. The result suggests that the global funds transmits the external EPU shocks to the US stock prices independently and even in the absence of the "fire-sale" channel. That is internal "re-allocation" implemented by the funds in the wake of EPU shocks it faces has significant pricing implications for the US stocks. Relative to the literature, we highlight the importance of re-allocation channel complementing the papers (JOTIKASTHIRA, LUNDBLAD, and RAMADORAI (2012)) documenting the importance of "fire-sale" mechanisms in transmission of shocks.

4.3.3 Effect of Liquidity Tightening on Fund response to EPU

Global institutional funds can propagate financial shocks in other ways. For instance, they can exacerbate the adverse liquidity shocks. We examine this possibility next. Specifically, we examine whether global shocks to funding liquidity affect a fund's response to economic policy uncertainty.

To the extent that monetary policy in a country may be endogenous to EPU, we use the 2013 US Fed taper tantrum episode as a shock to the availability of capital. Many emerging economies experienced a significant capital exodus following the announcement on 22 May 2013 that the US Federal Reserve might begin tapering down the bond purchases (López-Villavicencio and Pourroy (2021)). For instance, prior literature shows that lending flow to emerging markets contracted following the tapering episode (Avdjiev and Takáts (2014)).

In contrast to the above literature, we focus on the role of policy uncertainty in explaining the cross-section of equity capital outflows that ensued in the post-taper months. In particular, we examine whether the taper tantrum episode exacerbated equity capital outflows from countries with high economic uncertainty. To the extent that taper episode may affect post-Taper EPU, we define the pre-taper EPU for a given target country as the average EPU during the first quarter of 2013.[24] Formally, we estimate the following regression specification:

$$flow_{fct} = \alpha_{ft} + \sum_{t \in \mathcal{T}} \beta_t \left(\text{Pre-Taper EPU}\right)_c \times t + Controls_{ct} + \mu_c + \epsilon_{it} \tag{14}$$

where $\mathcal{T}$ denotes the window of 6 quarters from Q3 2012 to Q4 of 2013. Figure 1 presents the results. Relative to Q1-2013, countries having higher pre-taper EPU experienced substantially more capital outflows in Q2 and Q3. One standard deviation higher Pre-Taper EPU in a destination (relative to the destination's long-term mean EPU) results in a fund withdrawing 5.90%, 3.57%, and 3.23% more capital in Q2, Q3, and Q4 of 2013 from that destination (relative to its other investment destinations). Prior evidence suggests that June 2013 experienced substantial capital outflows, especially from equity markets, which continued throughout July-September 2013 (Sahay, Arora, Arvanitis, Faruqee, N'Diaye, and Griffoli (2014)). The taper shock was largely mitigated by the end of September 2013, with Fed committing to a bond-purchasing program for the foreseeable future. However, we see the impact of pre-taper EPU persisting even in Q4 of 2013.

[24] The results are qualitatively similar if we include the month of April 2013 as pre-taper period.

Table 13 reports the average treatments effects. Column 1 confirms the evidence reported in Figure 1. We find that funds withdraw more capital from destinations with high Pre-Taper EPU following the tapering episode. This is in addition to their reaction to the destination's EPU in the immediately lagged quarter. We focus on pre-Taper EPU in column 1 because post-Taper EPU is likely endogenous to the taper-induced liquidity shock.

Nonetheless, for completeness, in column 2, we investigate how the taper-tantrum episode affected fund response to contemporaneous (one-quarter lagged) EPU. We find that a liquidity shock significantly affects the fund response to EPU in a target country. First, focusing on the coefficient on destination EPU, we find that a one standard deviation increase in a destination country's EPU is associated with an approximately 3.4% (13.6%) decrease in quarterly (annual) fund inflows into that country. However, the negative association between destination EPU and fund flows doubles in magnitude post-Taper. In particular, in addition to the average response to destination EPU, post Taper, countries with one standard deviation higher EPU experienced an additional capital outflow of 3.6% per quarter. Overall, in the post-Taper period, a one standard deviation increase in a destination country's EPU is associated with an approximately 7% (=3.4%+3.6%) decrease in quarterly fund inflows into that country.

Overall, these results underscore the importance of EPU in explaining the cross-sectional variation in financial institutions' response to adverse liquidity shocks.

4.4 Additional Tests and Robustness

4.4.1 Extensive Margin

Thus far, our results document the intensive margin on fund's response to EPU. Specifically, our flow measure is well-defined only when we observe fund-destination assets for two consecutive quarters. Hence, by construction, the quarters in which a fund enters a particular destination or exits from it are excluded from the baseline. In this section, we present evidence regarding the impact of destination'ss EPU on the extensive margin (entry and exit) of the fund's capital allocation decision. To this end, we define the dummies capturing entry and exit. In particular, $\mathbb{1}(Entry_{fct})$ dummy takes a value of one when a fund f enters a destination country c for the first time during quarter t in our sample (excluding the first quarter of the sample-period itself) and zero otherwise. Similarly, we define the exit by a dummy $\mathbb{1}(Exit_{fct})$ which takes a value of one if an ongoing fund-destination pair until quarter $t-1$ ceases to exist in quarter t. To account for the fact that our exit definition might capture *missing data*, we also augment the exit definition to capture "permanent exits". In particular, we define $\mathbb{1}(\text{Perm. Exit}_{fct})$ to mean that a given fund-destination pair never appears in the data from that time onwards.[25]

Table 14 reports the results. For ease of interpretation, we multiply the dummies by 100 to interpret the coefficient estimates in percentage. Column 1 shows that one standard deviation higher destination EPU increases the probability of fund-destination exit next quarter by 0.39%. To mitigate the concern that the definition of exit merely captures the missing data for a quarter, we employ a more robust "Permanent Exit" definition in Column 3. Again, we obtain that one standard deviation higher destination EPU increases the probability of fund exiting the destination permanently by 0.30%. This is an economically large effect given that the unconditional probability of permanent exit is 1.49%. Column 4 focuses on entry. One standard higher destination EPU lowers the probability of a fund's entry into a destination by 0.13%, relative to the unconditional mean entry rate of 3.57%. Columns 2 and 5 allow for the possibility that entry and exit decisions are potentially based upon the long history of EPU rather than just the one-period lagged EPU. We obtain similar results for entry and exit probabilities.

[25] Obviously, for the last quarter when the fund itself ceases to exist in our sample, all the pairs for that fund will get marked as Exits. However, because we employ $Fund \times Time$ fixed effects, the last quarter of the sample, or for the fund, is excluded by construction as there is no within-fund variation in exit cross-destinations in those quarters.

4.4.2 Does Financial Uncertainty Explain Our Findings?

In this section, we try to distinguish between the news-based measure of economic policy uncertainty and uncertainty as measured by the financial markets (stock market volatility). To this end, we obtain cross-country data on implied stock market volatility or the VIX index and analyze if global funds react differently to EPU vis-a-vis stock market volatility.

Table A1 in Appendix A reports the correlation between VIX and EPU across the countries. As expected, EPU and VIX are positively correlated within the US, with a correlation coefficient of 0.34. However, there is substantial heterogeneity across the countries regarding the correlation between the two measures of uncertainties. On the one hand, Japan, Australia, and emerging countries like India and Mexico exhibit a positive correlation between VIX and EPU. On the other hand, China, the UK, and Russia have a strong negative relationship between VIX and EPU. The heterogeneity in the VIX-EPU relationship is not explained by whether the country is emerging or advanced. Importantly, there is substantial independent variation between the VIX and EPU, which can be exploited to estimate if funds react more aggressively to one versus the other.

In Table A2 reported in Appendix A, we examine whether the EPU-driven fund capital flight is robust to controlling for VIX. For ease of reference, we reproduce column 2 of Table 4 (our baseline specification) as column 1 of Table A2. Column 2 shows that funds withdraw capital from the destination country in response to the rise in financial market uncertainty (VIX). In column 3, we include both VIX and EPU simultaneously. We find that funds withdraw capital in response to an increase in both types of uncertainties, holding the other type of uncertainty constant. Moreover, the magnitude of fund flow sensitivity to EPU is slightly higher than that of VIX, but statistically indistinguishable. These results confirm that EPU has an independent impact on the capital allocation decisions of the global funds over and above the impact of the financial market uncertainty on their portfolio allocation decisions.

4.4.3 Re-estimating Flows With Actual Stock Returns

In our baseline estimation, we compute the fund-country flows (eq. 1) by approximating the fund-country returns simply by the returns on the broad stock market index for that country. In other words, we assume that the destination returns are the same for all funds investing in that particular destination. We rely on this approximation because of data constraints. Specifically, stock-level returns are not available for a large number of stocks held by global funds, especially for the stocks held in emerging markets. This approximation is also reasonable under the null that global funds actively over- or under-weight destinations in their portfolios but within a particular destination hold a portfolio close to the broad index. However, to alleviate concerns regarding the potential measurement error in the fund flows, we confirm that our results are robust even when we measure the fund-destination returns by using actual stock-level returns data (wherever available) and the portfolio holdings of the fund in that destination.

To this end, we use the Thomson Reuters EIKON database to obtain monthly stock returns. There are 88,954 unique stocks in our holdings data for all the funds across 21 destinations for which EPU data is available. Out of these, we successfully obtain actual returns data for 26,777 stocks. These stocks account for 53.46% of fund-destination-stock triplets in our sample. Not surprisingly, the coverage is 93.86% for the US Stocks. Excluding the US stocks, the mean coverage is 47.70%. Restricting our attention to stocks for which we have returns data, we use re-scaled portfolio weights on the matched sample and use these fund-destination portfolio returns to compute fund-destination flows as follows:

$$flow^{p}_{fct} = \frac{assets_{fct} - (1 + r_{fct})\, assets_{fct-1}}{(1 + r_{fct})\, assets_{fct-1}} \tag{15}$$

where $r_{fct} = \sum_{s=1}^{N_{fct}} w_{sfct} \times r_{st}$ denotes the fund-destination portfolio return during quarter t, s denotes the stock, and N_{fct} denotes the number of stocks held by fund f in destination c at time t, while w_{sfct} denotes the weight of portfolio on stock s within a fund-destination-quarter portfolio, r_{st}

denotes the time-t return on stock s. Note that compared to eq. 1, we replace r_{ct}, the country returns, with r_{fct}, the fund f returns specific to country c.

Reassuringly, the correlation between the fund-destination flows computed using portfolio and matched-stock returns ($flow^{p}_{fct}$) and our baseline fund-destination flows computed in eq. 1 is 0.95, validating our approximation and our main analyses. The high correlation between the approximate and actual flow measures suggests that global funds operate a strategy to optimize "country-weights" rather than engage in stock-picking.

Table A3 in Appendix A reports the results. In column 1, we reproduce the column 2 of Table 4 (our baseline specification) for comparison. In column 2, we use a stock-returns based measure of fund-destination flows and confirm the negative relationship between the lagged destination-EPU and the fund-destination flows. A one standard deviation increase in destination-EPU (relative to other destinations where the fund is invested in that quarter) results in a 1.25% fund-destination capital outflows on a quarterly basis, again relative to other destinations that the fund is invested in at that point in time. This coefficient magnitude is almost the same as in the baseline specification in column 1, and the estimates are statistically indistinguishable.

4.4.4 Destination Flows Vs. Destination Weights

Our baseline dependent variable is fund-destination capital flows. For robustness, in column 3 of Table A3 reported in Appendix A, we use the "destination-weight" in a fund's portfolio as a dependent variable. Consistent with our baseline results, we find that a standard deviation increase in destination-EPU results in a reduction of destination-weight by 0.873% next quarter. We note that a median fund invests in 10 countries in any given quarter with a median country weight of 8.03%. Thus, a 0.873% decrease in portfolio weight translates into an approximately 11% ($=\frac{0.873}{8.03}$) relative decrease for the median fund-country pair.[26]

[26] The mean destination-weight is 17.85% suggesting concentrated destination-positions in the portfolio.

5 Fund Performance

Does proactive portfolio reallocation away from the destinations experiencing higher economic uncertainty benefit funds? Ľuboš Pástor and Veronesi (2013) for example argue that higher political or economic uncertainty can have opposing effects on asset prices; one one hand, equity premium is pulled down by value of government's put protection. On the other hand, uncertainty itself pushes up the equity premium. Moreover, this political risk premium is larger in weaker economic states. Hence, a priori, it is unclear whether funds which diversify away from economic policy uncertainty perform better relative to those funds which bear more exposure to such uncertainty.

To answer this question, we proceed in three step

(1) Estimate fund's quarterly risk-adjusted performance against appropriate global benchmark

(2) Estimate quarterly covariance between fund-destination flows and destination EPU

(3) Estimate the relation between fund's risk-adjusted performance and the covariance between flows and EPU

To estimate the fund's risk-adjusted performance, we make use of global Fama-French factors. The funds we consider have global mandate, and as such should be evaluated against the investment opportunity set that was available to these funds. Hence, we consider Fama-French's Emerging Market (EM) and Developed Markets (DM) factors and construct an *global* factor whose returns are simple average of EM and DM factor returns. For example, we estimate global *excess market factor* denoted by *mktrf* as $\frac{\text{mktrf(EM)+mktrf (DM)}}{2}$. As a baseline, we consider a standard four-factor Fama-French (FF4 Henceforth) model, where we consider global version as defined above for each of the four factors, namely, excess market, SMB (Small-Minus-Big), HML (High-

Minus-Low), and Momentum factor. Equipped with these global factors, we estimate the fund i's monthly risk-adjusted performance as

$$r_{it}^{e} = \alpha_{it} + \beta_{it-1}'.F_{t}^{global} + \varepsilon_{it} \tag{16}$$

where r_{it}^{e} is fund's monthly excess return over US 1-month treasury bill rate, F_{t}^{global} is the 4×1 vector of global factor returns, and β_{it-1} is the 4×1 vector of factor betas for fund i estimated using return history of 60-months upto month $t-1$.[27] Then we average out the fund's alpha over a quarter.

Next, we exploit a nice feature of our data that we observe fund's capital allocation potentially across many destinations at a given point in time. This allows us to estimate average response of a fund to the destination specific EPU in terms of capital allocation using a cross-section of destinations. In particular, for a given quarter t for fund f, we estimate the covariance between fund-flows and EPU as

$$cov_{ft}\left(EPU_{c,t-1}, Flow_{fct}\right) = \sum_{k=1}^{K_{ft}} EPU_{c,t-1} \times \widetilde{Flows}_{fct} \tag{17}$$

where K_{ft} are the number of destinations in which a fund f is invested in at time t, and $\widetilde{Flows}_{fct}$ denotes the fund-destination time t flows demeaned by fund-flows for time t.[28] A negative cov_{ft} indicates that a fund withdraws more capital from a destination (relative to the average capital withdrawal across all destinations) in response to a rise in destination EPU and vice-versa.

[27] We require minimum 36 months of data to estimate beta and for the fund-month observation to be considered in the analysis.

[28] Demeaning allows us to absorb fund-quarter average flows for that quarter.

Equipped with both the inputs, we are finally in a position to answer the question if a proactive EPU management by a fund also generates better fund performance? In particular, we estimate a following regression at the fund-quarter level

$$\alpha_{ft} = \delta_{d,t} + \gamma_f + \beta.cov_{ft-1} + Controls_{ft} + \varepsilon_{ft} \tag{18}$$

where δ_{dt} denotes the host-country (country of the fund domicile) $\times$ time fixed effects, and γ_f denotes the fund fixed effects. We also include fund-level controls; in particular, we include fund's lagged assets, and number of destinations in which the fund was invested at time $t-1$.

The results are reported in table 15. Column 1 shows that fund's in top tercile of covariance underperform those in the bottom tercile by 4.5 basis points in α terms (in annual terms). The result is robust to including the fund controls too in column 3. A potential concern with covariance measure is that the covariance could be driven by larger EPU rather than larger reaction to EPU as measured by flows. Therefore in Column 2, we also consider a signed covariance measure.

$$cov_{ft}\left(EPU_{c,t-1}, Flow_{fct}\right) = \sum_{k=1}^{K_{ft}} sign(EPU_{c,t-1}) \times sign(\tilde{Flows}_{fct}) \tag{19}$$

where $sign(x)$ is a sign function which takes value of 1 if $x > 0$ and -1 if $x < 0$.

Column 2 shows that a unit increase in signed covariance of EPU and flows implies a 22 basis points reduction in fund's α over the next quarter in annual terms. This is not only statistically significant, but economically a large magnitude. The result is robust to including the fund controls too in column 5.

In last 2 columns, we consider fund's excess return as a performance measure rather than fund's α itself. Now we additionally control for fund's passive exposure to the four factors computed over last 60 months to control for the passive part of the fund's excess return. The results are still robust to this estimation with both the measures of covariances.

In conclusion, we document a statistically significant and economically modest outperformance of the funds which proactively divest away from the destinations experiencing larger EPU.

6 Conclusion

We investigate whether and how global institutional funds respond to news-based economic policy uncertainty (EPU) in investment destinations. We document several novel findings. Our main finding is that funds withdraw capital from foreign investment destinations in response to a rise in the destination country's EPU. We examine the economic channel that explain variation in the negative flow-EPU relationship across investment destinations. Funds react less negatively to a rise in EPU in G7 countries, especially to the spike in US EPU. But funds withdraw or reduce investments into non-G7 destinations in response to an increase in EPU in such destinations. Along the extensive margin, we find that a rise in destination EPU increases (decreases) the likelihood of funds exit (entry) from (into) the target country. Overall, our evidence suggests that the lower flow-EPU sensitivity documented for the G7 destinations is primarily explained by the "flight-to-safety" than the "home-bias".

Examining the role of other country-specific characteristics, we find that information, institutional strength, and familiarity mitigate the adverse effects of EPU. In particular, capital withdrawal in response to a spike in EPU is lower for countries that are more informationally transparent and those which rank higher in legal protection and democratic quality. Focusing on US funds, we show that cultural, legal, and geopolitical similarities also help funds resolve some of the destination-specific economic policy uncertainty. Specifically, US funds' uncertainty-related capital withdrawal is lower from countries similar to the US in ethnicity, language, legal origin, and geopolitical alignment.

Importantly, we document a novel channel of transmission of uncertainty-related financial shocks from one country to another through the global equity investments of mutual funds. Global funds withdraw capital from an investment destination in response to increased EPU exposure through other countries in their portfolio. The fund flow response to EPU in a specific destination is aggravated if the fund experiences high EPU in other investment destinations. We also document significant negative asset pricing implications for the US stocks *via* exposure of global funds holding these US stocks to the uncertainty emanating outside the USA.

Our study also adds to the literature on financial market implications of global funding liquidity shocks such as the Taper tantrum. Using the 2013 Taper exposure as a shock to liquidity, we show that funds withdraw more capital from economies facing higher economic uncertainty following the Taper shock. The negative association between destination EPU and fund flows doubles in magnitude post-Taper.

Out paper also adds an important dimension to the fund performance literature. We document that funds proactively managing their exposure to EPU outperform sluggish funds or funds taking the EPU exposure.

To the best of our knowledge, ours is the first study to examine the role of economic policy uncertainty in the equity allocations of global institutional funds.

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TABLE 1: List of Countries With EPU Data

The data lists the 21 countries for which the Economic Policy Uncertainty data is available.

Country	From	To
United Kingdom	1997	2019
Australia	1998	2019
Canada	1997	2019
Ireland	1997	2019
France	1997	2019
Greece	1998	2019
Hong Kong SAR	1998	2019
Italy	1997	2019
Japan	1997	2019
United States	1997	2019
Spain	2001	2019
Germany	1997	2019
Netherlands	2003	2019
Russian Federation	1997	2019
Brazil	1997	2019
Chile	1997	2019
China	1997	2019
Colombia	1997	2016
India	2003	2019
Mexico	1997	2019
Korea, Rep. (South)	1997	2019

TABLE 2: Summary

The table provides summary statistic for important variables used in the paper. The summary is computed on the set of funds in our final sample.

Panel A: Sample Description

	Total	Mutual Funds	Hedge Funds	Investment Advisors	Hedge Funds/ Investment Adisors
N#	18131	15953	179	1573	426
N# Advanced	16292	14461	164	1294	373

Panel B: Summary Statistics

	P25	P50	P75	Mean	SD
(a) Asset Coverage for 21 Countries	0.71	0.82	0.90	0.78	0.17
(b) No. of Destination Countries	7	10	14	10.40	4.91
(c) Assets (Mn $)					
(i) All Institutions	188.2	600.8	2054.8	9193.6	290775.1
(ii) US	458.9	1319.4	4172.0	13373.2	536525.5
(iii) Advanced	172.3	535.3	1784.3	8658.2	220205.0
(iv) Non-Advanced	60.2	212.5	863.3	3723.4	69086.0
(d) Destination Weight, %	3.05	8.34	22.66	17.85	23.04
(e) U.S Weight, %					
(i) *By US Funds*	0.01	2.51	15.30	12.17	18.54
(ii) *By Non-US Funds*	0.00	16.89	48.07	25.58	27.03
(f) Home Weight, %	0.00	2.13	17.99	11.44	17.11
(g) Destination Flows %	-13.27	1.39	31.79	44.14	151.51

TABLE 3: Cross-Country Correlation Between Economic Policy Uncertainty

The table provides cross-country correlation for Economic Policy Uncertainty (EPU) Index of Baker, Bloom, and Davis (2016). Panel A (B) lists Advanced (Emerging) economies. For each country, we report correlation with the US EPU (Column 1), World EPU (Column 2), and average correlation with other countries in the group (Advanced for Panel A and Emerging for Panel B).

Cross-Country Correlation Between Economic Policy Uncertainty

Panel A: Advanced Countries				**Panel B: Emerging Countries**			
Correlation With	US	World	Advanced		US	World	Emerging
UK	0.61	0.86	0.56	India	0.48	0.28	0.16
Australia	0.74	0.55	0.59	Mexico	0.27	0.08	-0.01
Ireland	0.59	0.69	0.56	Brazil	0.32	0.60	0.32
France	0.70	0.86	0.64	Chile	0.31	0.45	0.32
Greece	0.49	0.58	0.50	China	0.57	0.91	0.39
Italy	0.59	0.56	0.53	Russia	0.30	0.61	0.34
Japan	0.70	0.61	0.57				
Spain	0.63	0.55	0.52				
Germany	0.78	0.87	0.67				
Netherlands	0.59	0.30	0.41				
Hong Kong	0.45	0.58	0.37				
South Korea	0.76	0.78	0.42				
Canada	0.77	0.86	0.59				

TABLE 4: Policy Uncertainty and Global Fund Flows

This table reports the effect of the economic policy uncertainty in the destination country (Dest. EPU) on global fund flows. Formally, the reported coefficient estimates are from the following regression specification:

$$Flow_{fct} = \beta_1 EPU_{c,t-1} + \beta_2 X_{ct} + \alpha_{ft} + \mu_c + \epsilon_{fct}$$

where $Flow_{fct}$ refers to the capital flow by a fund f in destination country c at time t defined in the equation 1. $EPU_{c,t-1}$ (Dest. EPU) is the lagged *within-destination* standardized value of *Economic Policy Uncertainty* in destination country c. X_{ct} refers to lagged time-varying destination-level controls which include growth in the index of industrial production, change in country $c's$ exchange rate against USD, difference in lending rate between the country c and US, and finally the stock returns on the broad stock market index in the destination c. In columns 1-3, we focus on the sample of all global funds. In columns 4 and 5, we restrict the sample to USA domiciled funds and non-USA domiciled funds respectively. All covariates pertain to the destination country and recorded at the quarterly frequency. The data span the period 1998–2019. Standard errors reported in parentheses and are clustered at the fund level and are robust to heteroscedasticity. The fixed effects are as reported at the bottom of the table. Superscripts ***, ** ,* indicate significance at the 1%, 5%, and 10% level.

	Fund-Destination-Quarter Flows $(t+1)$ %				
				US Funds	Non-US Funds
	(1)	(2)	(3)	(4)	(5)
Destination. EPU	-0.489**	-1.276***	-0.909***	-1.582***	-1.129***
	(0.213)	(0.232)	(0.277)	(0.411)	(0.279)
Dest. IIP Growth		0.426***	0.262***	0.429***	0.431***
		(0.056)	(0.066)	(0.079)	(0.074)
Destination Exch. Rate % Appreciation		0.957	-6.994	6.894	-1.301
		(4.759)	(5.222)	(7.682)	(5.925)
"Dest-US" Lending Rate		1.019***	1.075***	1.370***	0.846***
		(0.098)	(0.109)	(0.197)	(0.112)
Destination Stock Return		-7.990**	-3.678	-14.150***	-4.219
		(3.196)	(3.704)	(5.318)	(3.957)
Destination FE	Y	Y		Y	Y
Time FE			Y		
Fund-Time FE	Y	Y		Y	Y
Fund-Destination FE			Y		
Adj-R2	0.657	0.657	0.179	0.536	0.677
Obs	574475	574475	675273	137828	436647

TABLE 5: Policy Uncertainty and Fund Flows: Home-Effects

Table tests for the presence of "home-bias" in the relation between the economic policy uncertainty in the destination country (Dest. EPU) and global fund flows. Dest. EPU is the lagged *within-destination* standardized value of *Economic Policy Uncertainty*. $\mathbb{1}$(Dest = Home) indicates that the destination is same as the fund's domicile country. Table estimates the differential flow response to Foreign and Home EPU for set of various funds; Column 1 includes all the funds irrespective of the domicile of the fund. Next we focus on funds domiciled within G7 countries (Column 2), within the U.S (Column 3), within rest of the G7 countries excluding US (Column 4), and finally within other Non-G7 economies (Column 5). In each column, the sample of the destination is unrestricted. All covariates pertain to the destination country and recorded at the quarterly frequency. Standard errors reported in parentheses are robust to heteroskedasticity and clustered at the fund level. The fixed effects are as reported at the bottom of the table. Superscripts ***, ** ,* indicate significance at the 1%, 5%, and 10% level.

	Fund-Destination-Quarter Flows ($t+1$) %				
Fund Domicile	All	G7	US	G7 Ex-USA	Non-G7
	(1)	(2)	(3)	(4)	(5)
Dest. EPU	-1.507***	-1.571***	-2.169***	-0.855**	-1.420***
	(0.456)	(0.287)	(0.418)	(0.391)	(0.395)
$\mathbb{1}$ (Dest. = Home)	6.310***	6.335***		-1.873	1.025
	(1.132)	(1.049)		(1.697)	(5.131)
Dest. EPU× $\mathbb{1}$ (Dest. = Home)	3.531***	3.658***	3.488***	2.022	0.346
	(1.001)	(0.799)	(0.925)	(1.479)	(2.610)
Dest. IIP Growth	0.410***	0.473***	0.405***	0.579***	0.273***
	(0.108)	(0.066)	(0.079)	(0.106)	(0.102)
Dest. Exch. Rate % Appreciation	1.009	7.084	6.058	7.050	-8.973
	(9.085)	(5.663)	(7.653)	(8.195)	(8.569)
Dest.-US Lending Rate Spread	1.037***	0.981***	1.405***	0.568***	1.150***
	(0.235)	(0.122)	(0.198)	(0.151)	(0.163)
Dest. Stock Return	-8.376	-9.481**	-15.620***	-1.900	-6.670
	(6.336)	(3.921)	(5.320)	(5.655)	(5.526)
Destination FE	Y	Y	Y	Y	Y
Fund-Time FE	Y	Y	Y	Y	Y
Adj-R2	0.657	0.617	0.536	0.649	0.699
Obs	574475	352437	137828	214609	222038

TABLE 6: Policy Uncertainty and "Flight-to-Safety"

Table reports the effect of the economic policy uncertainty in the destination country (Dest. EPU) on global fund flows for some important destinations. Dest. EPU is the the lagged *within-destination* standardized value of *Economic Policy Uncertainty.* For columns 1-4, we include only the "non-home" Fund-Destination pairs. For column 5, we include all fund-destination pairs, including home pairs. $\mathbb{1}$(Dest = x) is the dummy indicating that the destination country is x. $\mathbb{1}$(Dest = Home) is a dummy indicating if the destination is the home country for a given fund-destination pairs. All covariates pertain to the destination country and recorded at the quarterly frequency. The data span the period 1998–2019. Standard errors reported in parentheses are robust to heteroscedasticity and clustered at the fund level. The fixed effects are as reported at the bottom of the table. Superscripts ***, ** ,* indicate significance at the 1%, 5%, and 10% level.

	Fund-Destination-Quarter Flows $(t+1)$ %				
Destination	Any	Ex-US	Any		
	(1)	(2)	(3)	(4)	(5)
Dest.EPU	-1.696***	-2.461***	-2.542***	-2.539***	-2.641***
	(0.246)	(0.274)	(0.269)	(0.270)	(0.269)
Dest.EPU × $\mathbb{1}$ (Dest. = US)	1.934***			3.469***	
	(0.438)			(0.504)	
Dest.EPU × $\mathbb{1}$ (Dest. = G7 EX-US)		3.456***		3.552***	
		(0.481)		(0.452)	
Dest.EPU × $\mathbb{1}$ (Dest. = G7)			3.518***		3.262***
			(0.413)		(0.403)
$\mathbb{1}$ (Dest. = Home)					1.195
					(5.068)
Dest.EPU × $\mathbb{1}$ (Dest. = Home)					1.719
					(2.617)
$\mathbb{1}$ (Dest. = Home) × $\mathbb{1}$ (Dest. = G7)					5.927
					(5.184)
Dest.EPU ×$\mathbb{1}$ (Dest. = Home) × $\mathbb{1}$ (Dest. = G7)					0.458
					(2.748)
Dest. IIP Growth	0.413***	0.334***	0.343***	0.343***	0.333***
	(0.057)	(0.058)	(0.056)	(0.056)	(0.055)
Dest. Exch. Rate % Appreciation	2.801	-0.887	-3.387	-3.440	-4.784
	(4.890)	(5.317)	(5.034)	(5.059)	(4.895)
Dest.-US Lending Rate Spread	1.057***	1.097***	1.100***	1.100***	1.100***
	(0.100)	(0.103)	(0.101)	(0.101)	(0.099)
Dest. Stock Return	-7.325**	-8.184**	-6.235*	-6.204*	-7.858**
	(3.268)	(3.482)	(3.276)	(3.286)	(3.204)
Destination FE	Y	Y	Y	Y	Y
Fund-Time FE	Y	Y	Y	Y	Y
Adj-R2	0.669	0.660	0.669	0.669	0.657
Obs	522201	410093	522201	522201	574475

TABLE 7: Information Transparency and Institutional Strength

This table examines if funds' response to a destination's EPU (Dest. EPU) varies based on legal and political institutional quality of the destination country. Dest. EPU is the lagged *within-destination* standardized value of *Economic Policy Uncertainty* To this end, we split our sample into destinations with high and low quality of legal and political institutions and repeat our baseline tests; We split the sample into destinations with above and below median values of i) informational transparency (Columns 1-2), ii) strength and impartiality of the legal system (Columns 3-4), iii) rating of democratic strength (Columns 5-6). All the covariates pertain to the investment destination country and recorded at the quarterly frequency. The data span the period 1998–2019. Standard errors reported in parentheses are robust to heteroscedasticity and clustered at the fund level. Superscripts ***, ** ,* indicate significance at the 1%, 5%, and 10% level.

	Fund-Destination-Quarter Flows % (t+1)					
	Informational Transparency		Legal Strength		Democracy Strength	
	High (1)	Low (2)	High (3)	Low (4)	High (5)	Low (6)
Dest. EPU	-0.212	-2.392***	0.221	-2.111***	0.032	-4.579***
	(0.741)	(0.352)	(0.730)	(0.293)	(0.319)	(0.435)
Dest. IIP Growth	-0.218	0.574***	-0.091	0.534***	0.241***	0.811***
	(0.151)	(0.081)	(0.141)	(0.076)	(0.071)	(0.112)
Dest. Exch. Rate % Appreciation	5.206	9.651	6.905	9.158	-12.425**	3.885
	(14.774)	(6.284)	(15.523)	(6.542)	(5.628)	(10.816)
Dest.-US Lending Rate Spread	-0.149	1.076***	-1.554***	1.191***	-0.364	1.353***
	(0.762)	(0.112)	(0.564)	(0.108)	(0.258)	(0.119)
Dest. Stock Return	-3.770	-12.679***	-21.461*	-7.617*	-10.908**	-12.137*
	(10.484)	(4.687)	(12.863)	(4.423)	(4.457)	(6.265)
Fund-Time FE	Y	Y	Y	Y	Y	Y
Country FE	Y	Y	Y	Y	Y	Y
Adj-R2	0.699	0.694	0.749	0.653	0.698	0.688
Obs	107960	208201	131077	232881	392571	130887

TABLE 8: Does Familiarity Reduce the Effect of Policy Uncertainty?

This table examines if US domiciled funds' response to a destination EPU (Dest. EPU) varies based on cultural similarity with that destination. Dest. EPU is the lagged *within-destination* standardized value of *Economic Policy Uncertainty* To this end, we split our sample into countries with high and low similarity with the USA and repeat our baseline tests. In columns 1 (2) repeat the tests for sub-sample of destinations that share (don't share) a common language with the USA. In column 3 (4), we focus on the sub-sample of destinations with above (below) median value of ethnic similarity measure based on Kolo (2012). In columns 5 and 6, we focus on the sample of countries that share common law and civil law legal origin. Finally,in columns 7 and 8, we split the sample into destinations with above and below median values of UNGA voting alignment scores, All the covariates pertain to the investment destination country and recorded at the quarterly frequency. The data span the period 1998–2019. Standard errors reported in parentheses are robust to heteroscedasticity and clustered at the fund level. Superscripts ***, ** ,* indicate significance at the 1%, 5%, and 10% level.

	Fund-Destination-Quarter Flows % (t+1)							
	Common Language		Ethinically Similar		Same Legal Origin		Geo-politically alignment	
	Yes	No	Yes	No	Yes (Common Law)	No (Civil Law)	High	Low
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Dest. EPU	0.429	-3.480***	-0.003	-2.153***	0.811	-3.261***	-0.227	-2.086***
	(0.575)	(0.347)	(0.726)	(0.291)	(0.825)	(0.319)	(0.800)	(0.294)
Dest. IIP Growth	0.226*	0.496***	-0.066	0.556***	0.591***	0.344***	-0.117	0.539***
	(0.124)	(0.084)	(0.141)	(0.076)	(0.175)	(0.068)	(0.163)	(0.074)
Dest. Exch. Rate % Appreciation	-0.612	14.527**	1.956	9.716	-7.637	11.530*	12.731	12.320**
	(12.824)	(6.948)	(15.586)	(6.423)	(16.034)	(6.164)	(17.647)	(6.186)
Dest.-US Lending Rate Spread	-1.385***	1.245***	-1.302**	1.227***	-1.739***	1.183***	-1.130	1.190***
	(0.477)	(0.108)	(0.548)	(0.106)	(0.621)	(0.108)	(0.922)	(0.109)
Dest. Stock Return	-13.915	-13.648***	-18.210	-11.009***	-14.674	-12.188***	-19.452	-5.334
	(8.514)	(4.476)	(12.866)	(4.116)	(9.967)	(4.031)	(14.558)	(4.195)
Fund-Time FE	Y	Y	Y	Y	Y	Y	Y	Y
Country FE	Y	Y	Y	Y	Y	Y	Y	Y
Adj-R2	0.712	0.670	0.747	0.663	0.729	0.676	0.777	0.635
Obs	166450	196724	131818	237573	112226	257936	100133	267072

TABLE 9: Transmission of Uncertainty Shocks through Fund Portfolios

Table reports the effect of the destination and fund-specific economic policy uncertainty (Dest. EPU and Fund EPU, respectively) on global fund flows. Dest. EPU is the lagged *within-destination* standardized value of *Economic Policy Uncertainty* in destination country c. Fund EPU or FundEPU$_{f/c,t}$ measures the fund-level EPU exposure weighted across destinations, excluding the destination country (c) under consideration and is defined in the equation 5 as follows

$$\text{FundEPU}_{f/c,t} = \sum_{c' \in \mathcal{C}_{ft}, c' \neq c} \left(\frac{assets_{fc',t}}{assets_{f/c,t-1}} \right) \times EPU_{c',t}$$

All the covariates pertain to the investment destination country and recorded at the quarterly frequency. The data span the period 1998–2019. Standard errors reported in parentheses are robust to heteroscedasticity and clustered at the fund level. The fixed effects are as reported at the bottom of the table. Superscripts ***, ** ,* indicate significance at the 1%, 5%, and 10% level.

	Fund-Destination-Quarterly Flows $(t+1)$ %				
	(1)	(2)	(3)	(4)	(5)
Destination EPU	-1.844***	-0.581			-2.062***
	(0.295)	(0.493)			(0.296)
Fund EPU	-3.860***		-1.401**		-5.505***
	(1.003)		(0.663)		(1.070)
$\mathbb{1}$ (Fund EPU > 0)		-22.004***		-5.840***	
		(1.014)		(0.777)	
Dest. EPU×$\mathbb{1}$ (Fund EPU > 0)		-2.483***		-1.942***	
		(0.508)		(0.531)	
Fund EPU×$\mathbb{1}$ (Dest = G7)					2.137***
					(0.473)
Dest. IIP Growth	0.443***	0.442***			0.412***
	(0.055)	(0.056)			(0.054)
Dest. Exch. Rate % Appreciation	4.885	5.523			5.479
	(4.696)	(4.764)			(4.686)
Dest.-US Lending Rate Spread	0.987***	1.066***			0.998***
	(0.101)	(0.098)			(0.101)
Dest. Stock Return	-10.109***	-6.546**			-11.831***
	(3.178)	(3.196)			(3.158)
Destination FE	Y	Y			Y
Fund-Time FE	Y	Y			Y
Destination-Time FE			Y	Y	
Fund-Destination FE			Y	Y	
Adj-R2	0.660	0.658	0.206	0.200	0.660
Obs	519245	574475	1404988	1578557	519245

TABLE 10: EPU Transmission and Stock Returns

This table examines the effect of transmission of the Ex-USA Economic Policy Uncertainty (EPU) on to the US stocks. Dependent variable for columns 1-4 is the stock's risk-adjusted quarterly return computed using Fama-French & Carhart fouur-factor model. The The main independent variable (Stock EPU) is computed as

$$\text{Stock-EPU (Ex-USA)}_{st} = \sum_f W_{sft} \times \text{Fund-EPU (ex-USA)}_{ft}$$

where W_{sft} is the fraction of stock s owned by fund f at time t and Fund-EPU $(\text{ex-USA})_{ft}$ is that fund $f's$ EPU exposure outside the US computed as the weighted average of EPU it experiences outside the US, where weights are given by the fraction of that fund's investment in each country Ex-USA. Dependent variable for column 5 is stock's Amihud illiquidity measure. Fixed effects are as reported below. The data span the period 1998–2019. Standard errors reported in parentheses are robust to heteroscedasticity and clustered at the stock level. Superscripts ***, ** ,* indicate significance at the 1%, 5%, and 10% level.

	Stock's Four-Factor Risk-Adjusted Return (t+1)				Illiquidity
	(1)	(2)	(3)	(4)	(5)
Std. Stock EPU (t-1)	-3.585***	-2.997**	-2.639**	-9.837***	0.083***
	(1.146)	(1.178)	(1.228)	(1.394)	(0.006)
Stock's % Owned by Institutional Owners (t-1)		-9.132***	-8.549***	-37.171***	-0.144***
		(2.670)	(2.055)	(11.125)	(0.045)
Log Assets (t-1)			0.041	0.934***	0.005***
			(0.190)	(0.194)	(0.000)
Log Market Cap(t-1)			-0.279*	-2.688***	-0.004***
			(0.155)	(0.172)	(0.000)
B/M (t-1)			18.268***	46.668***	0.120***
			(1.385)	(2.154)	(0.014)
Dividend Yield (t-1)			25.831**	-14.390	0.055
			(11.627)	(17.703)	(0.096)
Stock Volatility (t-1)			0.439	27.777	-0.529***
			(10.806)	(19.245)	(0.078)
Stock Excess Ret (t-1)			-44.374***	-82.670***	-0.024***
			(3.428)	(3.670)	(0.009)
Momentum (t-3:t-1)			14.827***	-17.441***	-0.050***
			(3.325)	(3.401)	(0.005)
Momentum (t-12:t-4)			31.487***	-36.741***	-0.200***
			(5.613)	(5.874)	(0.014)
Adj-R2	0.011	0.011	0.015	0.069	0.749
Obs	319138	319138	278396	278030	180732
Controls	N	N	Y	Y	Y
Time (Quarter) FE	Y	Y	Y	Y	Y
Stock FE	N	N	N	Y	Y

TABLE 11: Disentangling EPU Transmission on Stock Returns and Foreign Exposure of Stocks

This table disentangles the transmission of the Ex-USA Economic Policy Uncertainty (EPU) on to the US stocks and the effects on the stock returns due to stock's international exposure. Dependent variable is the stock's risk-adjusted quarterly return computed using Fama-French & Carhart fouur-factor model. The Stock EPU, and Stock's World R^2 are measured using equations 7, and 11 respectively. Fixed effects are as reported below. The controls include Stock's Market Capitalization fraction owned by the funds, Log Assets, Log Market Capitalization, Book-To-Market, Dividend Yield, stock's prior volatility measured over 60 months prior to the start of the quarter, stock's 1-month, 3-month, and 9-months previous to 3-months lagged returns.The data span the period 1998–2019. Standard errors reported in parentheses are robust to heteroscedasticity and clustered at the stock level. Superscripts ***, ** ,* indicate significance at the 1%, 5%, and 10% level.

	Stock's Four-Factor Risk-Adjusted Return (t+1)		
	(1)	(2)	(3)
Std. Stock EPU (t-1)	-9.839***	-10.254***	-8.605***
	(1.394)	(1.410)	(1.441)
% Foreign Pre-Tax Income	0.037***		
	(0.004)		
Stock's World R^2		42.672***	
		(13.614)	
$\mathbb{1}$(Top 10% Stock's World R^2)			8.048***
			(3.010)
Std. Stock EPU (t-1) $\times$ $\mathbb{1}$(Top 10% Stock's World R^2)			-10.750***
			(2.447)
Adj-R2	0.069	0.070	0.070
Obs	278030	274897	274897
Controls	Y	Y	Y
Quarter FE	Y	Y	Y
Stock FE	Y	Y	Y

TABLE 12: EPU Transmission and Stock Returns: Role of Fire-Sales and Re-allocation

This table quantifies the role of "Fire-Sale" mechanism in explaining the transmission of the Ex-USA Economic Policy Uncertainty (EPU) on to the US stocks. Dependent variable is the stock's risk-adjusted quarterly return computed using Fama-French & Carhart four-factor model. The Stock EPU, Stock redemption and Stock Pressure are computed using equations 7, 12, and 13 respectively. The fixed effects are as indicated at the bottom. The controls include Stock's Market Capitalization fraction owned by the funds, Log Assets, Log Market Capitalization, Book-To-Market, Dividend Yield, stock's prior volatility measured over 60 months prior to the start of the quarter, stock's 1-month, 3-month, and 9-months previous to 3-months lagged returns. The data span the period 1998–2019. Standard errors reported in parentheses are robust to heteroscedasticity and clustered at the stock level. Superscripts ***, ** ,* indicate significance at the 1%, 5%, and 10% level.

	Stock's Four-Factor Risk-Adjusted Return (t+1)			
	(1)	(2)	(3)	(4)
Std. Stock EPU (t-1)	-7.658***	-10.201***	-7.444***	-10.125***
	(1.387)	(1.394)	(1.384)	(1.419)
Redemption (%)	-8.974***		-8.987***	
	(0.367)		(0.369)	
Pressure		-7.686***		-7.651***
		(0.469)		(0.484)
Stock EPU (t-1)×Redemption (%)			0.339	
			(0.315)	
Stock EPU (t-1)×Pressure				-0.129
				(0.421)
Adj-R2	0.073	0.070	0.073	0.070
Obs	278030	278030	278030	278030
Controls	Y	Y	Y	Y
Time (Quarter) FE	Y	Y	Y	Y
Stock FE	Y	Y	Y	Y

TABLE 13: Does Liquidity Tightening Exacerbate The Effect of Policy Uncertainty?

Table reports the effect of the ex-ante destination economic policy uncertainty in the destination country (Dest. EPU) on global fund flows around Taper-Tantrum Episode on May 2013. The destination EPU (Dest. EPU) is the lagged *within-destination* standardized value of *Economic Policy Uncertainty.* The data ranges from Q3 of 2012 to Q4 of 2013 and $\mathbb{1}(Post)$ identifies Q2, Q3,and Q4 of 2013. Pre-Taper Dest. EPU measures the destination monthly EPU averaged over January-March (Q1) of 2013. The table reports estimates from the following model

$$flows_{fct} = \alpha_{ft} + (\mathrm{z})_c \times \mathbb{1}(Post) + Controls_{ct} + \mu_c + \epsilon_{it}$$

where z can be lagged Destination EPU or Pre-Taper EPU. All the covariates pertain to the investment destination country and recorded at the quarterly frequency. Standard errors reported in parentheses are robust to heteroscedasticity and clustered at the fund level. The fixed effects are as reported at the bottom of the table. Superscripts ***, ** ,* indicate significance at the 1%, 5%, and 10% level.

	% Fund-Destination-Quarter Flows $(t+1)$	
	(1)	(2)
Dest. EPU	-3.515***	-3.430***
	(1.165)	(1.172)
$\mathbb{1}$ (Post Taper) × Dest. Pre-EPU	-5.064***	
	(1.435)	
$\mathbb{1}$ (Post Taper) × Dest. EPU		-3.618**
		(1.695)
Dest. IIP Growth	-0.687**	-0.697**
	(0.293)	(0.306)
Dest. Exch. Rate % Appreciation	20.147	12.692
	(17.037)	(18.082)
Dest-US Lending Rate Spread	-1.916***	-2.034***
	(0.350)	(0.354)
Dest Stock Return	-19.430*	-20.767*
	(11.606)	(11.636)
Destination FE	Y	Y
Fund-Time FE	Y	Y
Adj-R2	0.658	0.658
Obs	51166.000	51166.000

TABLE 14: Policy Uncertainty Extensive Margin of Capital Allocation

This table reports the effect of the economic policy uncertainty in the destination country (Dest. EPU) on the entry and the exit decisions of the global funds into that particular destination. The dependent variable in columns 1 and 2 is the Exit by a fund from a particular destination defined by a dummy $\mathbb{1}\,(Exit_{fct})$ which takes a value of 1 if a fund-destination pair was in existence last quarter but is not in this quarter. In Column 3 instead, we define our dependent variable by a dummy $\mathbb{1}\,(\text{Permenant Exit}_{fct})$ if the fund exits the destination permanently. Similarly, dependent variable in columns 4-5 is given by $\mathbb{1}\,(Entry)$ which is a dummy which take a value of 1 if a fund-destination pair appears for the first time in the sample in that quarter. We report the Exit and Entry dummies in % terms by multiplying the dummies by 100. All the covariates pertain to the investment destination country and recorded at the quarterly frequency. Standard errors reported in parentheses are robust to heteroskedasticity and clustered at the fund level. The fixed effects are as reported at the bottom of the table. Superscripts ***, ** ,* indicate significance at the 1%, 5%, and 10% level.

	Exit_{fct} %		$\text{Permanent Exit}_{fct}$ %	Entry_{fct} %	
	(1)	(2)	(3)	(4)	(5)
Dest. EPU	0.396***		0.308***	-0.132***	
	(0.027)		(0.020)	(0.019)	
Rolling Mean of Dest. EPU		0.219***			-0.132***
		(0.033)			(0.023)
Dest. IIP Growth	-0.110***	-0.111***	-0.084***	0.049***	0.050***
	(0.006)	(0.006)	(0.004)	(0.005)	(0.005)
Destination Exch. Rate % Appreciation	-0.356	0.227	-0.192	-0.027	-0.204
	(0.462)	(0.458)	(0.296)	(0.373)	(0.370)
Destination-US Lending Rate Spread	-0.027***	-0.018**	-0.044***	0.012**	0.011**
	(0.007)	(0.007)	(0.004)	(0.005)	(0.006)
Destination Stock Return	-3.016***	-3.531***	-2.159***	2.475***	2.649***
	(0.330)	(0.329)	(0.213)	(0.297)	(0.295)
Fund × Time FE	Y	Y	Y	Y	Y
Destination FE	Y	Y	Y	Y	Y
Adj R-Sq	0.933	0.933	0.588	0.778	0.778
Obs	803719	803719	807347	821109	821109

TABLE 15: Exposure to Policy Uncertainty and Fund Performance

This table reports the fund performance as a function of Flow-EPU covariance. The fund performance is measured as fund's alpha computed using Global Fama-French four factor model as described in equation 16. Covariance denotes the fund-flow and EPU covariance and is computed using measure developed in equation 17 and 19. All the dependent variables are computed at time t. Factor beta controls are the average factor exposure of the fund on four global Fama-French factors computed over past 60 months up to time t. Fund excess returns are computed in excess of US 1-month treasury rates. The fixed effects are as reported at the bottom of the table. Superscripts ***, ** ,* indicate significance at the 1%, 5%, and 10% level. The errors are clustered at fund level

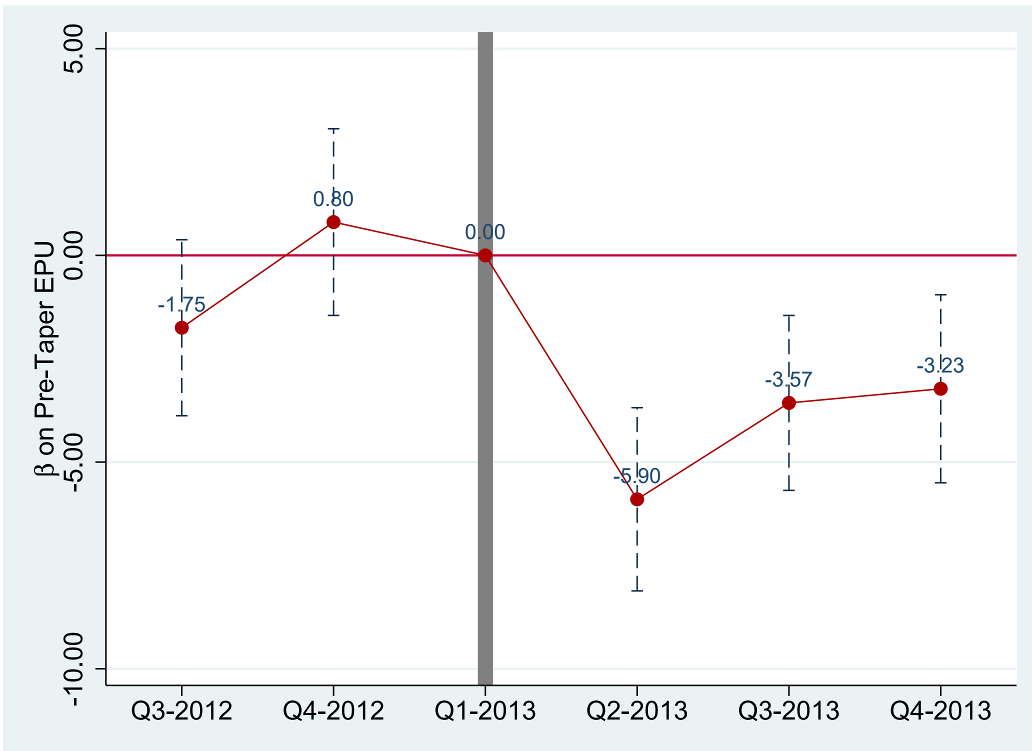
	Fund Alpha (α_{t+1})%				Fund Excess Returns (t+1) %	
	(1)	(2)	(3)	(4)	(5)	(6)
Mid Tercile of Flow-EPU Cov	0.017		0.016		-0.013	
	(0.025)		(0.025)		(0.027)	
Top Tercile of Flow-EPU Cov	-0.045**		-0.042**		-0.053**	
	(0.019)		(0.019)		(0.022)	
Sign-Based Flow-EPU Covariance		-0.227***		-0.230***		-0.207**
		(0.082)		(0.083)		(0.103)
Log Assets			-0.088***	-0.091***	-0.100***	-0.104***
			(0.023)	(0.023)	(0.029)	(0.029)
No. of Destinations			-0.004	-0.004	-0.009	-0.009
			(0.005)	(0.006)	(0.006)	(0.006)
Adj-R2	0.413	0.416	0.415	0.418	0.219	0.223
Obs	38719	37895	38303	37486	36127	35369
Factor Beta Controls					Y	Y
Host Country×Time FE	Y	Y	Y	Y	Y	Y
Fund FE	Y	Y	Y	Y	Y	Y

Figure 1: Liquidity Tightening During Taper Tantrum and Effect of Policy Uncertainty on Global Investments

In this figure, we plot the difference-in-difference coefficients (β_t) estimated from the following model

$$flows_{fct} = \alpha_{ft} + \sum_{t \in \mathcal{T}} \beta_t \,(\text{Pre-Taper EPU})_c \times t + Controls_{ct} + \mu_c + \epsilon_{it}$$

The vertical gray line indicates the onset of the Taper-Episode in the May of 2013. The dotted lines around the point estimates indicate 95% confidence intervals. Q1-2013 serves as the base quarter in the estimation. Model includes set of controls used throughout the paper. Model also absorbs target country and Fund×Time fixed effects. Standard errors reported in parentheses are robust to heteroscedasticity and clustered at the fund level.



Appendix A

The Appendix reports results of additional tests that are briefly described in the text. Additional details are available from the authors upon request.

TABLE A1: Correlation Between VIX and EPU

The table reports the correlation between The Cboe Volatility Index (VIX) and the Economic Policy Uncertainty (EPU) for each of the destination countries for which the data on both VIX and EPU is available. Both the variables are averaged over a given quarter from the monthly time-series before computing the correlation.

Destination Country	ρ(EPU, VIX)
United Kingdom	-0.46
Australia	0.61
Hong Kong SAR	0.05
Japan	0.62
United States	0.34
Germany	0.07
Russian Federation	-0.53
Brazil	0.17
China	-0.63
India	0.47
Mexico	0.40
Korea, Rep. (South)	-0.04

TABLE A2: Financial Vs. Economic Policy Uncertainty

Table reports the effect of the destination economic policy uncertainty in the destination country (Dest. EPU) and destination financial uncertainty (Dest. VIX) on global fund flows. Dest. EPU and Dest. VIX are both lagged and standardized *within-destination*. Financial uncertainty in the destination country is measured using options data and obtained from The Bloomberg. All the covariates pertain to the investment destination country and recorded at the quarterly frequency. The data span the period 1998–2019. Standard errors reported in parentheses are robust to heteroscedasticity and clustered at the fund level. The fixed effects are as reported at the bottom of the table. Superscripts ***, ** ,* indicate significance at the 1%, 5%, and 10% level.

	% Fund-Destination-Quarter Flows % (t+1)		
Dest.EPU	-1.276***		-1.035***
	(0.232)		(0.240)
Dest. VIX		-1.245***	-0.865**
		(0.355)	(0.351)
Dest.IIP Growth	0.426***	0.491***	0.491***
	(0.056)	(0.061)	(0.061)
Dest. Exchange Rate % Appreciation	0.957	6.504	7.367
	(4.759)	(4.797)	(4.796)
Dest.-US Lending Rate	1.019***	0.884***	0.962***
	(0.098)	(0.089)	(0.094)
Dest. Stock Return	-7.990**	-7.797**	-9.069***
	(3.196)	(3.390)	(3.412)
Destination FE	Y	Y	Y
Fund × Time FE	Y	Y	Y
Adj-R2	0.657	0.686	0.686
Obs	574475	462541	462541

TABLE A3: Policy Uncertainty and Global Fund Flows: Robustness

Table reports the effect of the economic policy uncertainty in the destination country (Dest. EPU) on global fund flows under alternative specifications. Dest. EPU is the lagged *within-destination* standardized value of *Economic Policy Uncertainty.* In Column 1, we reproduce the Column 4 of Table 4. Column 2, uses as a dependent variable, the fund-destination flows computed using stock returns as in equation 15. Column 3 uses fund-destination weight in fund's portfolio as the dependent variable. All the covariates pertain to the investment destination country and recorded at the quarterly frequency. Standard errors reported in parentheses are robust to heteroscedasticity and clustered at the fund level. The fixed effects are as reported at the bottom of the table. Superscripts ***, ** ,* indicate significance at the 1%, 5%, and 10% level.

Dep. Var	Fund-Destination-Quarter Flows (t+1) %		Fund-Destination Weight (t+1)
Computed Using	(Baseline)	(Stock Returns)	
	(1)	(2)	(3)
Dest. EPU	-1.276***	-1.254***	-0.873***
	(0.232)	(0.345)	(0.056)
Dest. IIP Growth	0.426***	0.360***	-0.021*
	(0.056)	(0.092)	(0.013)
Dest. Exchange. Rate % Appreciation	0.957	3.748	6.303***
	(4.759)	(6.950)	(0.565)
Dest.-US Lending Rate Spread	1.019***	1.435***	0.191***
	(0.098)	(0.151)	(0.025)
Dest. Stock Return	-7.990**	4.908	-0.106
	(3.196)	(4.775)	(0.480)
Fund×Time FE	Y	Y	Y
Country FE	Y	Y	Y
Adj-R2	0.657	0.636	0.475
Obs	574475	376166	574475