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Portfolio Rebalancing by Mutual Funds in Response to Government Policy

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This paper studies how changes in U.S. trade policy shape mutual funds' portfolio choice and performance. We show that funds reduce their holdings in industries targeted by tariff cuts, and these reallocations are followed by significant performance declines. The underperformance is strongest among funds with industry expertise constraints and is driven by poor stock selection when shifting into unfamiliar industries. In contrast, funds increase their exposure to industries affected by tariff hikes, especially when industries are less dependent on export sales, and among funds with more aggressive trading and greater expertise in the targeted industries. Despite these sizable portfolio shifts, we find no evidence that increasing exposure to tariff-hike industries improves performance. Instead, the tilt toward tariff-hike targeted industries appears to reflect managers' local bias toward home-state industries and partisan-driven economic expectations following tariff hikes, rather than superior information or investment skill.

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