2026 International Journal of Management Science Research, Vol.9, Issue 3, (Mar)
ISSN 2536-605X
DOI: 10.53469/ijomsr.2026.09(03).07

How Does Market Sentiment Influence Fund Investors' Capital Allocation Decisions?

Feifei Zhang, Shanshan Li*

Research Institute of International Economics and Management, Xihua University, Chengdu, Sichuan, China
Correspondence Author

1. INTRODUCTION

In recent years, China's sustained economic growth and evolving financial markets have fueled rapid expansion in household wealth and significantly heightened demand for professional asset management, propelling the rapid development of the public fund industry. The continuous rise in the number of fund products and asset management scale has gradually positioned funds as a vital channel for households to participate in capital markets and allocate wealth. However, alongside this industry expansion, the market structure dominated by individual investors has also led to pronounced irrational characteristics in investment behavior. Constrained by limited access to information and investment experience, investors' capital allocation decisions rely not only on a fund's historical performance but are also easily swayed by market conditions and emotional fluctuations. This has led to the phenomenon where “funds make money while fund investors do not,” attracting widespread attention from both academia and practitioners.

Existing research indicates that fund capital flows typically exhibit significant sensitivity to historical performance, meaning investors tend to allocate funds to those with past strong returns. However, the stability of this relationship remains controversial. On one hand, traditional studies often rely on rational expectations frameworks, viewing capital flows as investors' rational responses to performance information. On the other hand, behavioral finance suggests that investor sentiment influences risk perception and return expectations, thereby altering the investment decision-making process. During heightened market volatility or shifts in investment sentiment, fund flows may increasingly reflect emotion-driven factors rather than fundamental information. Therefore, analyzing fund flow mechanisms solely through the lens of fund performance may fail to fully capture investors' actual allocation behavior.

From a behavioral finance perspective, this paper incorporates market environment factors into the framework for studying fund capital flows, focusing on examining the impact mechanisms of market conditions and market sentiment on the capital flow-performance relationship. Specifically, this paper first tests the fundamental relationship between fund performance and capital flows. Building upon this, it further analyzes how this relationship changes under different market conditions. By constructing market sentiment indicators, it explores the moderating role of investor sentiment on capital allocation behavior, aiming to explain the formation mechanism of capital flows in China's fund market from a behavioral perspective.

The main contributions of this paper are threefold: First, it reexamines fund capital flows from an investor behavior perspective, introducing market sentiment factors beyond traditional performance-based frameworks to provide a new analytical dimension for understanding the capital flow-performance relationship. Second, by distinguishing between market state and market sentiment as two types of market environment variables, this study systematically examines the differences in investor capital allocation responses under varying market conditions, helping to reveal the context-dependent characteristics of capital flow mechanisms. Third, based on empirical evidence from China's public fund market, this study provides supplementary evidence for understanding capital allocation behavior in markets dominated by individual investors, offering reference value for investor behavior research and fund market practice.

2. LITERATURE REVIEW

2.1 Flow-Performance Relation

In financial market research, the Flow-Performance Relation has long been a subject of extensive academic interest. Traditional financial theory posits that under conditions of perfect information and rational investors, capital

should flow toward better-performing asset management products, thereby achieving efficient capital allocation. Early studies found that fund investors generally base investment decisions on historical performance, with fund capital flows exhibiting significant sensitivity to past returns (Ippolito, 1992; Gruber, 1996; Chevalier and Ellison, 1997; Ferreira et al., 2010; Jin Guo et al., 2020; Cheng et al., 2024). Sirri and Tufano (1998) used U.S. mutual fund data, demonstrated a nonlinear relationship between fund flows and performance: top-performing funds attract more inflows, while underperforming funds experience relatively limited outflows.

Subsequent studies across diverse markets and samples have validated the universality of this relationship. Chevalier and Ellison (1997) found investors tend to select funds based on short-term performance, with capital flows reflecting investors' assessments of management capabilities. Further research indicates factors like fund size, fee structures, and disclosure levels also influence the intensity of capital's response to performance, though performance remains the core explanatory variable.

In the Chinese market context, where retail investors constitute a significant proportion, the fund flow-performance relationship exhibits more pronounced behavioral characteristics. Domestic studies consistently find that investors are more likely to chase funds with recent outperformance, resulting in a distinct “performance chasing” phenomenon in asset allocation (Li Yao & Yu Jinjie, 2004; Shu Jinghong, 2005; Lu Rong et al., 2007; Wang Huijian et al., 2007; Wang Zebo &Wang Xing, 2017; Wu & Zhang, 2024). However, some scholars argue that such capital reactions may reflect behavioral biases rather than rational expectations, as investors often overemphasize short-term information while neglecting performance persistence (Feng Jinyu, 2012; Xiao Jihui, 2016; Wu and Zhang, 2024).

While existing literature indicates that a fund's historical performance significantly influences investor capital allocation, controversy persists regarding whether capital flows consistently reflect rational decision-making. Based on the aforementioned theoretical and empirical evidence, this study proposes the following research hypothesis:

H1: A significant positive correlation exists between a fund's historical performance and investor capital flows, meaning funds with better performance are more likely to attract capital inflows.

2.2 The Role of Market Sentiment

Although traditional studies emphasize the importance of fund performance information, behavioral finance suggests that investor decision-making is often systematically influenced by emotional factors. Prospect theory proposed by Kahneman and Tversky(1979) shows that individuals are not fully rational under uncertainty; instead, their risk preferences vary with psychological states, which may lead asset allocation to deviate from the rational equilibrium.

In asset pricing and mutual fund research, market sentiment is regarded as an important factor affecting investors'risk perception and capital flows. The investor sentiment index constructed by Baker and Wurgler(2006) indicates that asset prices are more likely to deviate from fundamental values during periods of high sentiment. Under optimistic sentiment, investors exhibit stronger risk appetite and are more inclined to chase high-return assets, whereas depressed sentiment reinforces risk aversion and leads to more conservative capital allocation.

With respect to fund flows, existing studies find that during periods of high sentiment, investors are more likely to chase funds with strong recent performance, thereby generating positive feedback inflows(Wen & Zhang, 2021). However, sentiment-driven inflows may cause fund size to expand rapidly, which in turn increases transaction costs, dilutes investment opportunities, and harms subsequent performance, giving rise to the negative size–performance relationship(Wang et al., 2020). Empirical evidence from the Chinese market also shows a negative relationship between investor sentiment and subsequent fund performance, confirming the theoretical expectation that sentiment-driven investment may reduce returns.

Market sentiment may also moderate the sensitivity of fund flows to fund performance. In general, better fund performance attracts more capital inflows, whereas poorer performance leads to stronger redemption pressure. However, in a high-sentiment environment, investors become more tolerant of short-term drawdowns, and the fund flow-performance sensitivity is weakened. By contrast, during periods of low sentiment, even a slight decline in performance may trigger large-scale redemptions, thereby creating a vicious cycle (Wu & Zhang, 2024).

In recent years, the measurement of market sentiment has become increasingly diversified. Early studies mainly relied on single indicators, such as closed-end fund discounts or the number of IPOs, whereas more recent research tends to adopt principal component analysis (PCA) (Song et al., 2023), partial least squares (PLS) (Song & Yu, 2023), or machine learning methods (Wu & Zhang, 2024) to combine multiple proxy variables into a composite sentiment index. Empirical results suggest that sentiment indicators constructed using these methods have stronger explanatory power in predicting market fluctuations and fund behavior. In the Chinese market, studies usually focus on indicators such as the number of newly opened accounts, the new highs–new lows index, the CCTV BSI index, the consumer confidence index, or the CICSI sentiment index (Yi & Mao, 2009). Since this paper focuses on the role of market sentiment in shaping investor behavior in China, the CICSI sentiment index is selected as the core measure of market sentiment.

In the fund market, sentiment may affect capital flows through two channels. First, it may alter investors' interpretation of fund performance information, thereby moderating the sensitivity of capital flows to performance signals. Second, it may directly affect subscription and redemption behavior, causing capital flows to display procyclical characteristics. Research on the Chinese market also shows a significant relationship between investor trading behavior and sentiment indicators, suggesting that sentiment has strong explanatory power in a market dominated by individual investors. Taken together, incorporating market sentiment variables helps provide a more comprehensive understanding of investor capital allocation behavior. Based on behavioral finance theory, this paper proposes the following hypothesis:

H2: Market sentiment has a significant impact on fund flows. During periods of high market sentiment, investor capital inflows increase significantly.

3. DATA AND VARIABLES

3.1 Data Sources and Screening

The data in this paper is primarily sourced from the CSMAR Equity Research Database and the Fund Research Database. These datasets include key metrics such as fund net asset value per unit, cumulative net asset value, fund size, subscription and redemption details, fund manager information, and corresponding capital market transaction variables.

This study focuses on actively managed equity funds and equity-oriented hybrid funds in the domestic fund market. First, we excluded bond-oriented hybrid funds with equity holdings accounting for less than 50% of their portfolios or holding fewer than 10 stocks. We also excluded bond funds, money market funds, index funds, as well as structured funds such as leveraged funds and QDII funds, to avoid confounding effects arising from differing investment strategies. Second, given that estimating fund excess returns and risk exposure factors requires at least two years of net asset value data, this study excludes funds with a track record of less than two years to mitigate the impact of short-term capital flows on empirical results. Furthermore, existing research indicates that outliers in fund size may distort estimates of the relationship between fund size and performance (DeMiguel et al., 2023; Lan, 2024). Consequently, this study adopts a point-in-time exclusion principle, removing observations only during specific time periods when the fund size is below 10 million yuan, rather than excluding the entire fund, to preserve as much sample information as possible.

Given that the CICSI Market Sentiment Index data used in this study was published as of September 2023, and to ensure consistency in the sample period and data availability, the final study sample period was set from January 1, 2005, to September 30, 2023. Based on the above screening criteria, this study ultimately obtained a sample of 4,571 funds meeting the research criteria, comprising a total of 79,535 quarterly observations.

3.2 Variable Definition

1) Fund Performance Measurement

Fund performance serves as a critical basis influencing investors' capital allocation decisions. This paper employs multi-factor asset pricing models to estimate risk-adjusted excess returns as a performance metric, thereby mitigating potential biases from single-model assumptions. Specific models include the single-factor CAPM, the Fama-French three-factor model, the Fama-French five-factor model, the China-specific CH3 and CH4 models, and the Q-factor model.

The CAPM is specified as follows:

$$R_{i,t} - R_{f,t} = \alpha_i + \beta_i \left(R_{m,t} - R_{f,t}\right) + \varepsilon_{i,t} \quad (1)$$

Here, $R_{i,t}$ denotes the return of fund i in period t, $R_{f,t}$ represents the risk-free rate, and $R_{m,t}$ signifies the market return in period t.

The Fama-French three-factor model incorporates the size factor (SMB) and value factor (HML) on top of the market factor:

$$R_{i,t} - R_{f,t} = \alpha_i + \beta_{iRMRF} RMRF_{i,t} + \beta_{iSMB} SMB_{i,t} + \beta_{iHML} HML_{i,t} + \varepsilon_{it} \quad (2)$$

Furthermore, the five-factor model incorporates the profitability factor (RMW) and the capital market risk factor (CMA) to capture the fundamental characteristics of firms:

$$R_{i,t} - R_{f,t} = \alpha_i + \beta_i \left(R_{m,t} - R_{f,t}\right) + \beta_{iSMB} SMB_{i,t} + \beta_{iHML} HML_{i,t} + \beta_{iRMW} RMW_{i,t} + \beta_{iCMA} CMA_{i,t} + \varepsilon_{it} \quad (3)$$

Considering the characteristics of the Chinese market, this paper further employs the Chinese three-factor and four-factor models, where the CH4 model incorporates a momentum factor (PMO) on top of the CH3 framework. Additionally, the Q-factor model is adopted to characterize risk exposure from the perspectives of investment and profitability:

$$R_{i,t} - R_{f,t} = \alpha_i + \beta_i MKT_t + \beta_{iSMB} SMB_t + \beta_{iVMG} VMG_t + \varepsilon_{it} \quad (4)$$

$$R_{i,t} - R_{f,t} = \alpha_i + \beta_i MKT_t + \beta_{iSMB} SMB_t + \beta_{iVMG} VMG_t + + \beta_{iPMO} PMO_t + \varepsilon_{it} \quad (5)$$

Among these, MKT_t represents the market risk premium factor, SMB_t denotes the size factor, VMG_t signifies the value factor, and PMO_t indicates the momentum factor.

$$R_{i,t} - R_{f,t} = \alpha_i + \beta_{iMKT} MKT_t + \beta_{iME} ME_t + \beta_{iIA} IA_t + \beta_{iROE} ROE_t + \beta_{iEG} EG_t + \varepsilon_{it} \quad (6)$$

Among these, MKT_t denotes the market factor, ME_t represents the size factor, IA_t signifies the investment factor, ROE_t indicates the profitability factor, and EG_t stands for the expected investment growth factor.

The alpha values estimated from different models serve as proxy indicators for fund performance and are utilized in subsequent empirical analysis.

2) Market Sentiment Measurement

Market sentiment serves to characterize the collective psychological state of investors and shifts in market risk appetite. Within the Chinese market context, existing research has proposed various sentiment measurement methods, such as new account openings, the High/Low Index (HI/LO), the CCTV Stock Watch Index (BSI), the Bull/Bear Index, and the Consumer Confidence Index. However, some indicators suffer from issues including strong subjectivity, limited sample coverage, or insufficient stability.

Balancing theoretical foundations, data continuity, and representativeness, this paper selects the CICSI Sentiment Index as the core market sentiment metric. Constructed through multidimensional market variables, this index comprehensively reflects investor sentiment fluctuations, making it more suitable for long-term quantitative research.

3) Control Variables

To control for the impact of fund characteristics on capital flows, this study introduces the following control variables: fund company size, fund age, fund turnover rate, fund return volatility, and fund expense ratio. These variables characterize fund heterogeneity across institutional scale, lifecycle attributes, trading behavior, and risk levels, thereby reducing omitted variable bias.

3.3 Descriptive Statistics

Table 1 reports the descriptive statistics for key variables. The mean fund flow for the dependent variable is 0.0356, indicating a slight net inflow across all funds during the sample period. Its standard deviation is 0.496, with

maximum and minimum values of 3.349 and -0.754, respectively. This indicates significant variations in subscription and redemption behaviors across different funds, reflecting strong volatility and heterogeneity in investor capital flows.

The core explanatory variable, fund returns, exhibits an overall positive trend. The mean of the raw return rate is 0.0204, meaning the average quarterly return rate for funds during the sample period was approximately 2.04%. However, its standard deviation reached 0.109, with returns ranging from -32.1% to 75.9%, indicating pronounced fluctuations in fund performance across different market phases and a highly dispersed return distribution. This characteristic also provides essential cross-sectional variation for testing investors' allocation responses to performance information.

The mean of the market sentiment variable was 0.642, indicating overall optimistic sentiment during the sample period. However, its standard deviation of 0.755 signaled substantial fluctuations in sentiment. The indicator's range extended from −1.137 to 3.117, revealing that the market experienced diverse sentiment states—from pronounced pessimism to heightened optimism—during the study period. This provides ample time-series variability for subsequent analysis of market sentiment's impact on investor capital flow behavior.

Overall, all key variables exhibited pronounced volatility characteristics and distributional differences, establishing a robust data foundation for subsequent empirical analysis.

Table 1: Descriptive Statistics Table

Variable	Obs	Mean	SD	Min	Max
flow	77,616	0.0331198	0.4968347	-0.7562903	3.344227
Return	79,535	0.0204324	0.1091591	-0.3207276	0.7591748
a_CAPM	79,535	0.0104438	0.068875	-0.3168162	0.5702967
a_FF3	79,535	0.0114504	0.0621437	-0.3112476	0.5888549
a_FF5	79,535	0.0113896	0.0623351	-0.3132742	0.6126021
a_CH3	79,535	0.0209187	0.0639591	-0.2864998	0.6663523
a_CH4	79,535	0.0212361	0.0632852	-0.3044771	0.7044671
a_Q	79,535	0.0133034	0.0965434	-0.3045734	0.7035061
TNA	79,535	1.53e+09	3.09e+09	1.00e+07	8.99e+10
FamilyTNA	79,535	2.57e+11	3.22e+11	4655540	1.80e+12
lnFamilyTNA	79,535	25.3885	1.571145	15.35357	28.21895
FundAge	79,535	5.760873	3.74627	2	22
Volatility	79,535	0.0924909	0.0499448	0.0006905	1.04908
FeeRatio	79,535	0.0068377	0.0031696	0.0003346	0.0216657
Turnover	75,888	1.605536	1.568085	0.031516	8.432124
sentiment	79,535	0.6418148	0.7555255	-1.136667	3.116667

1)***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively; t-values are reported in parentheses.

4. EMPIRICAL ANALYSIS

4.1 Benchmark Regression

To examine whether a fund's historical performance significantly influences future capital inflows—that is, whether investors select funds based on past performance—this paper adopts the following benchmark model, drawing on the research of Gruber (1996) and Sirri and Tufano (1998):

$$flow_{i,t} = a_i + \beta_1 r_{i,t-1} + +\beta_2 Controls_{i,t-1} + \mu_{it-1} \quad (7)$$

Here, $flow_{i,t}$ denotes the net fund inflow rate of fund i in quarter t, $r_{i,t-1}$ represents the historical performance one quarter lagged, and $Controls_{i,t-1}$ signifies the control variables.

This study employs both fixed-effects models and the Fama–MacBeth (1973) method for estimation, calculating fund risk-adjusted returns based on CAPM, FF3, and FF5 models. Table 2 results indicate that the historical performance coefficient remains significantly positive across different model specifications. For instance, under the fixed-effects framework, the performance coefficient derived from the FF3 model is 1.029 with a t-value of 9.12, significant at the 1% level. This result indicates that better-performing funds attract greater future capital

inflows, reflecting a widespread behavioral tendency among investors to allocate funds based on historical performance. The Fama-MacBeth regression yields consistent findings, confirming that this relationship holds at the cross-sectional level and thus supporting the existence of significant performance chasing behavior in the fund market.

Table 2: Baseline regression results

Variables	(1)	(2)	(3)	(4)	(5)	(6)
	FE			Fama_Macbeth		
	CAPM	FF3	FF5	CAPM	FF3	FF5
l_return	0.938***	1.029***	0.987***	1.101***	1.097***	1.034***
	(7.652)	(9.120)	(8.433)	(9.903)	(9.435)	(9.269)
l_FundAge	-0.568***	-0.568***	-0.566***	-0.00310	-0.00314*	-0.00321*
	(-7.131)	(-7.130)	(-7.094)	(-1.651)	(-1.696)	(-1.753)
l_Volatility	0.348	0.293	0.256	-0.374	-0.227	-0.279
	(1.447)	(1.212)	(1.093)	(-1.419)	(-0.777)	(-1.020)
l_FeeRatio	55.12***	54.13***	53.90***	51.98***	51.07***	50.75***
	(4.396)	(4.309)	(4.295)	(5.848)	(5.761)	(5.702)
l_lnFamilyTNA	-0.00131	0.000186	0.000233	0.00292	0.00264	0.00269
	(-0.158)	(0.0224)	(0.0278)	(1.448)	(1.310)	(1.325)
l_Turnover	-0.0272*	-0.0253	-0.0252	-0.0526***	-0.0509***	-0.0507***
	(-1.686)	(-1.559)	(-1.554)	(-4.292)	(-4.193)	(-4.159)
Constant	3.015***	2.985***	2.980***	-0.298***	-0.294***	-0.291***
	(6.020)	(5.912)	(5.886)	(-3.689)	(-3.599)	(-3.564)
Obs N	71,172	71,172	71,172	71,408	71,408	71,408
R-squared	0.150	0.151	0.150	0.110	0.109	0.107
Quarter FE	Y	Y	Y			
Fund FE	Y	Y	Y			

***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively; t-values are reported in parentheses.

4.2 Emotional Regulation Effects

4.2.1 Impact of Market Conditions

Considering that market environments may alter investor decision-making behavior, this study introduces a market state variable and constructs an interaction model to examine changes in the performance-capital flow relationship across different market phases. The market state variable is defined as follows:

$$MarketState_t = \begin{cases} 1 \ , \ |\ ExcessReturn_t\ | \leq 5\% \\ 0 \ , \ |\ ExcessReturn_t| \ > 5\% \end{cases} \quad (8)$$

MarketState denotes the market state in quarter t, while ExcessReturn represents the market's excess return in quarter t—that is, the difference between the market return and the risk-free rate during the same period.

Based on this, the extended model is as follows:

$$flow_{i,t} = a_i + \beta_1 r_{i,t-1} + \beta_2 MarketState_{t-1} + \beta_3 r_{i,t-1} * MarketState_{t-1} + \beta_4 Controls_{i,t-1} + \mu_{it-1} \quad (9)$$

The interaction term tests whether investors' fund selection response strengthens or weakens during market stability. If $\beta_3 > 0$, it indicates that the relationship between fund performance and capital flows becomes more pronounced during relatively stable market periods.

The regression results (Table 3) show that the fund performance coefficient remains significantly positive under both estimation methods, further validating investors' performance-chasing behavior. However, the market state variable itself exhibits differences across estimation frameworks: the coefficient is significantly negative in the fixed-effects model, while it is positive but not significant in the Fama-MacBeth regression. This indicates that overall market improvement does not consistently translate into uniform capital allocation differences across the cross-section.

More critically, the interaction term between performance and market state is negative in most models and passes significance tests under certain specifications. This indicates that when market conditions improve, the marginal impact of fund performance on capital inflows actually weakens, suggesting investors become less reliant on performance signals.

Table 3: The impact of general market conditions on FPR

Variables	(1)	(2)	(3)	(4)	(5)	(6)
	FE			Fama Macbeth		
	CAPM	FF3	FF5	CAPM	FF3	FF5
l_return	0.914***	1.061***	1.014***	1.164***	1.155***	1.127***
	(7.211)	(9.002)	(8.049)	(8.168)	(7.930)	(7.751)
l_MarketState	-0.0406***	-0.0392***	-0.0401***	0.0229	0.0121	0.00581
	(-6.094)	(-6.091)	(-5.910)	(0.639)	(0.400)	(0.194)
RetState	-0.0482	-0.289*	-0.278*	-0.0931	-0.312	-0.389**
	(-0.240)	(-1.923)	(-1.744)	(-0.375)	(-1.656)	(-2.073)
l_FundAge	-0.568***	-0.568***	-0.566***	-0.00284	-0.00289*	-0.00294*
	(-7.083)	(-7.063)	(-7.028)	(-1.670)	(-1.694)	(-1.749)
l_Volatility	0.263	0.207	0.170	-0.355	-0.194	-0.264
	(1.106)	(0.859)	(0.726)	(-1.509)	(-0.708)	(-1.030)
l_FeeRatio	55.13***	54.32***	54.09***	52.45***	51.68***	51.54***
	(4.402)	(4.329)	(4.315)	(5.812)	(5.779)	(5.746)
l_lnFamilyTNA	-0.00148	9.75e-06	-3.77e-05	0.00318	0.00279	0.00276
	(-0.179)	(0.00117)	(-0.00449)	(1.564)	(1.377)	(1.348)
l_Turnover	-0.0278*	-0.0263	-0.0262	-0.0534***	-0.0521***	-0.0521***
	(-1.725)	(-1.621)	(-1.615)	(-4.328)	(-4.288)	(-4.281)
Constant	3.048***	3.013***	3.011***	-0.299***	-0.290***	-0.281***
	(6.053)	(5.927)	(5.908)	(-3.541)	(-3.412)	(-3.304)
Observations	71,172	71,172	71,172	71,408	71,408	71,408
R-squared	0.151	0.152	0.152	0.119	0.118	0.117
Quarter FE	Y	Y	Y			
Fund FE	Y	Y	Y			

***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively; t-values are reported in parentheses.

Additionally, considering that normal market conditions may obscure behavioral differences under extreme scenarios, this paper further distinguishes investor behavior across different market extremes by categorizing market states into extreme upward conditions (RightTail) and extreme downward conditions (LeftTail). The following model is constructed:

$$flow_{i,t} = a_i + \beta_1 r_{i,t-1} + \beta_2 RightTail_{t-1} + \beta_3 LeftTail_{t-1} + \beta_4 r_{i,t-1} * RightTail_{t-1} + \beta_5 r_{i,t-1} * LeftTail_{t-1} + \beta_6 Controls_{i,t-1} + \mu_{it-1} \quad (10)$$

$RightTail$ indicates 1 when the market excess return exceeds 5%, and 0 otherwise; $LeftTail$ indicates 1 when the market excess return falls below -5%, and 0 otherwise.

Further distinguishing extreme market conditions (Table 4) reveals pronounced asymmetry: during extreme bear markets, the interaction term between performance and downturn status is significantly negative. This indicates that as market panic intensifies, investors become significantly less sensitive to historical performance, with capital flows increasingly driven by risk-aversion motives. Conversely, during extreme bull phases, the interaction term is significantly positive, suggesting that optimistic market conditions amplify investors' performance-chasing behavior.

Overall, market conditions not only influence capital flow levels but also systematically alter the intensity of investors' reactions to fund performance information.

Table 4: The regulatory effect of market extremes

Variables	(1)	(2)	(3)	(4)	(5)	(6)
	FE			Fama Macbeth		
	CAPM	FF3	FF5	CAPM	FF3	FF5
l_return	0.861***	0.745***	0.709***	1.035***	0.831***	0.733***
	(4.002)	(4.646)	(4.533)	(4.597)	(4.319)	(3.927)
l_RightTail	0.0145	0.0182	0.0261	-0.0481	-0.0152	-0.0462
	(0.729)	(1.090)	(1.527)	(-0.613)	(-0.165)	(-0.375)
l_LeftTail	0.0138	0.0208	0.0181	0.0703	0.0725	0.283
	(0.666)	(1.192)	(1.027)	(0.661)	(0.771)	(1.143)
RetRightTail	0.361	0.614***	0.537**	1.247	0.960	1.161
	(1.456)	(2.930)	(2.392)	(1.638)	(1.495)	(1.293)
RetLeftTail	-0.553***	-0.278**	-0.264**	-0.204	-0.538	1.183
	(-3.316)	(-2.583)	(-2.240)	(-0.152)	(-0.678)	(0.594)
l_FundAge	-0.568***	-0.567***	-0.566***	-0.00247	-0.00258	-0.00265
	(-7.031)	(-7.040)	(-7.001)	(-1.143)	(-1.201)	(-1.223)
l_Volatility	0.230	0.198	0.169	-0.426	-0.251	-0.311
	(0.942)	(0.829)	(0.734)	(-1.570)	(-0.881)	(-1.180)
l_FeeRatio	55.19***	54.44***	54.19***	52.41***	51.68***	51.48***
	(4.418)	(4.355)	(4.334)	(6.517)	(6.478)	(6.467)
l_lnFamilyTNA	-0.00155	-0.000106	-0.000213	0.00323	0.00286	0.00276
	(-0.188)	(-0.0127)	(-0.0254)	(1.589)	(1.410)	(1.353)
l_Turnover	-0.0283*	-0.0271	-0.0269	-0.0529***	-0.0519***	-0.0519***
	(-1.763)	(-1.675)	(-1.659)	(-4.122)	(-4.095)	(-4.084)
Constant	3.013***	2.979***	2.977***	-0.275***	-0.277***	-0.273***
	(5.943)	(5.852)	(5.829)	(-4.189)	(-4.259)	(-4.224)
Observations	71,172	71,172	71,172	71,408	71,408	71,408
R-squared	0.152	0.154	0.153	0.125	0.124	0.123
Quarter FE	Y	Y	Y			
Fund FE	Y	Y	Y			

***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively; t-values are reported in parentheses.

4.2.2 The Moderating Role of Market Sentiment

Beyond market trends, investor psychological expectations may also influence capital allocation behavior. To this end, this paper introduces market sentiment indicators and constructs a model incorporating performance and sentiment interaction terms. The specific model is as follows:

$$flow_{i,t} = a_i + \beta_1 r_{i,t-1} + \beta_2 Sentiment_{t-1} + \beta_3 r_{i,t-1} * Sentiment_{t-1} + \beta_4 Controls_{i,t-1} + \mu_{it-1} \quad (11)$$

When investors are in extreme states, investor sentiment exerts a significant influence on stock markets (Kaplanski and Levy, 2010). Therefore, this paper groups sentiment variables into quantiles to construct states of extreme sentiment elevation and extreme sentiment depression, thereby exploring the nonlinear and asymmetric moderating effects of extreme sentiment states on investor behavior. The specific construction is as follows:

$$RightTailSent_t = \begin{cases} 1 \ , Sentiment_t > P80 \\ 0 \ , \ Sentiment_t < P80 \end{cases} \quad (12)$$

$$LeftTailSent_t = \begin{cases} 1 \ , \ Sentiment_t < P20 \\ 0 \ , \ Sentiment_t > P20 \end{cases} \quad (13)$$

Table 5 results indicate that in fixed-effects models, fund performance still significantly promotes capital inflows. Moreover, the interaction term between performance and sentiment is significantly positive in most models, suggesting that market sentiment amplifies the positive impact of performance on capital flows. When market sentiment is high, investors are more inclined to select funds based on historical performance, thereby amplifying the correlation between performance and capital flows.

Table 5: Regression Results on the Moderating Effect of Market Sentiment on FPR

Variables	(1)	(2)	(3)	(4)	(5)	(6)
	FE			Fama_Macbech		
	CAPM	FF3	FF5	CAPM	FF3	FF5
l_return	0.770***	0.936***	0.917***	-0.454	-0.498	-0.482
	(9.612)	(12.51)	(12.86)	(-1.281)	(1.343)	(1.346)
l_sent	-0.0959	-0.0754	-0.0762	-0.788	-0.818	-0.434
	(-0.853)	(-0.663)	(-0.673)	(-1.167)	(0.673)	(0.520)
RetSent	0.193***	0.100*	0.0733	0.428**	0.952***	0.642***
	(3.009)	(1.773)	(1.394)	(2.520)	(3.224)	(3.150)
l_FundAge	-0.571***	-0.570***	-0.569***	-0.00285	-0.00292	-0.00300
	(-7.636)	(-7.625)	(-7.597)	(-1.261)	(0.00222)	(0.00224)
l_Volatility	0.353**	0.292**	0.257*	-0.296	-0.148	-0.209
	(2.463)	(2.020)	(1.757)	(-1.019)	(0.303)	(0.277)
l_FeeRatio	55.05***	54.03***	53.83***	51.34***	50.45***	50.11***
	(16.47)	(16.15)	(16.08)	(6.326)	(8.106)	(8.114)
l_lnFamilyTNA	-0.00122	0.000283	0.000342	0.00367*	0.00336	0.00343
	(-0.161)	(0.0374)	(0.0450)	(1.774)	(0.00206)	(0.00210)
l_Turnover	-0.0270***	-0.0251***	-0.0251***	-0.0520***	-0.0503***	-0.0500***
	(-3.363)	(-3.137)	(-3.125)	(-4.017)	(0.0128)	(0.0128)
Constant	3.092***	3.046***	3.042***	0.440	0.514	0.235
	(6.140)	(6.028)	(6.004)	(0.651)	(0.661)	(0.559)
Observations	71,172	71,172	71,172	71,408	71,408	71,408
R-squared	0.150	0.151	0.151	0.130	0.129	0.126
Quarter FE	Y	Y	Y			
Fund FE	Y	Y	Y			

***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively; t-values are reported in parentheses.

Further examination of extreme sentiment states (Table 6) reveals a significant asymmetric moderation effect. During periods of extreme optimism, the performance-emotion interaction term was significantly positive, indicating heightened investor risk appetite and greater capital concentration toward top-performing funds. Conversely, during extreme pessimism, the interaction term was significantly negative in the Fama-MacBeth regression, reflecting increased investor risk aversion and a marked decline in historical performance's explanatory power over capital allocation. These findings suggest that market sentiment significantly influences fund capital flows by altering investors' risk perceptions and decision-making preferences.

Table 6: Regression Results on the Impact of Extreme Market Sentiment

Variables	(1)	(2)	(3)	(4)	(5)	(6)
	FE			Fama_Macbech		
	CAPM	FF3	FF5	CAPM	FF3	FF5
l_return	0.853***	0.975***	0.934***	0.863***	0.760*	0.941
	(12.86)	(16.85)	(17.23)	(0.274)	(0.433)	(0.564)
l_sentRight	0.0252**	0.0178	0.0181	0.0288	-0.0787	-0.123*
	(2.141)	(1.491)	(1.529)	(0.136)	(0.0693)	(0.0708)
l_sentLeft	0.0115	0.0130	0.0135	-0.0510	-0.0461	-0.0394
	(0.797)	(0.906)	(0.938)	(0.0872)	(0.0864)	(0.0884)
RetSentLeft	-0.149	-0.168	-0.131	-1.390***	-4.645***	-3.844***
	(-1.094)	(-1.311)	(-1.015)	(3.778)	(5.009)	(4.186)
RetSentRight	0.636***	0.381***	0.349**	-0.568	2.064	2.951***
	(4.287)	(2.730)	(2.536)	(0.792)	(1.763)	(2.861)
l_FundAge	-0.548***	-0.549***	-0.548***	-0.00288	-0.00292	-0.00299
	(-7.374)	(-7.333)	(-7.296)	(0.00227)	(0.00223)	(0.00224)
l_Volatility	0.227	0.170	0.137	-0.324	-0.177	-0.232
	(1.546)	(1.138)	(0.903)	(0.294)	(0.310)	(0.285)
l_FeeRatio	52.20***	51.03***	50.77***	51.98***	51.16***	50.83***
	(16.04)	(15.59)	(15.50)	(8.125)	(8.114)	(8.124)

Variables	(1)	(2)	(3)	(4)	(5)	(6)
	FE			Fama_Macbech		
	CAPM	FF3	FF5	CAPM	FF3	FF5
l_lnFamilyTNA	-0.00140	0.000123	9.98e-05	0.00326	0.00296	0.00304
	(-0.188)	(0.0165)	(0.0134)	(0.00201)	(0.00201)	(0.00204)
l_Turnover	-0.0254***	-0.0234***	-0.0233***	-0.0525***	-0.0509***	-0.0507***
	(-3.248)	(-2.989)	(-2.971)	(0.0130)	(0.0129)	(0.0129)
Constant	3.077***	3.054***	3.049***	-0.155	-0.148	-0.145
	(6.208)	(6.110)	(6.080)	(0.116)	(0.114)	(0.111)
Observations	66,365	66,365	66,365	71,408	71,408	71,408
R-squared	0.147	0.148	0.147	0.118	0.117	0.115
Quarter FE	Y	Y	Y			
Fund FE	Y	Y	Y			

***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively; t-values are reported in parentheses.

4.3 Robustness Test

4.3.1 Robustness Tests of the Benchmark Regression

To test the robustness of the benchmark regression results, this paper further re-estimates fund performance alpha using the Chinese versions of the CH3 and CH4 factor models, as well as the Q-factor model, developed by Liu et al. (2019). Based on these estimates, we analyze the impact of fund performance on fund net flows. The regression results are presented in Table 7. As shown, regardless of whether the CH3, CH4, or Q-factor model is used to measure fund excess returns, the coefficient of the core explanatory variable l_return is significantly positive in all regressions. This result is fully consistent with the conclusion from the benchmark regression in Section 4.2, indicating that the positive impact of fund performance on capital flows does not depend on a specific performance measurement model and exhibits strong robustness.

Table 7: Robustness Tests of the Benchmark Regression

Variables	(1)	(2)	(3)	(4)	(5)	(6)
	FE			Fama-Macbeth		
	CH3	CH4	Q	CH3	CH4	Q
l_return	0.912***	0.904***	0.660***	1.025***	0.984***	0.914***
	(7.043)	(6.829)	(4.714)	(8.180)	(7.988)	(8.678)
l_FundAge	-0.566***	-0.567***	-0.559***	-0.00332*	-0.00333*	-0.00322*
	(-7.102)	(-7.164)	(-6.737)	(-1.788)	(-1.786)	(-1.732)
l_Volatility	0.205	0.186	0.379	-0.461*	-0.460*	-0.418*
	(0.837)	(0.764)	(1.611)	(-1.775)	(-1.810)	(-1.702)
l_FeeRatio	54.17***	54.11***	54.02***	51.50***	51.44***	51.34***
	(4.313)	(4.300)	(4.318)	(5.802)	(5.786)	(5.762)
l_lnFamTNA	-0.000541	-0.000327	-0.00120	0.00278	0.00286	0.00317
	(-0.0650)	(-0.0395)	(-0.144)	(1.398)	(1.440)	(1.506)
l_Turnover	-0.0264	-0.0264	-0.0257	-0.0528***	-0.0531***	-0.0515***
	(-1.636)	(-1.632)	(-1.599)	(-4.338)	(-4.345)	(-4.231)
Constant	2.996***	2.996***	2.967***	-0.287***	-0.289***	-0.300***
	(5.928)	(5.986)	(5.733)	(-3.595)	(-3.616)	(-3.579)
Obs N	71,172	71,172	71,172	71,408	71,408	71,408
R-squared	0.149	0.149	0.145	0.108	0.108	0.108
Quarter FE	Y	Y	Y			
Fund FE	Y	Y	Y			

1)***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively; t-values are reported in parentheses.

4.3.2 Robustness Tests of the Effect of Market Conditions on the Fund Flow–Performance Relationship

1) The impact of general market conditions on the relationship between fund flows and performance

To test the robustness of the effect of market conditions on the relationship between fund flows and performance, this section recalculates fund excess returns based on the CH3, CH4, and q-factor models. The robustness test results are reported in Table 8.

It can be seen that the coefficient on the interaction term between fund performance and market conditions (RetState) remains negative under both estimation methods, but it is statistically significant only under the Fama–MacBeth estimation specification. This finding further strengthens the previous inference that market conditions do exert a negative moderating effect on the fund performance–fund flow relationship.

Table 8: Robustness Tests of the Effect of Market Conditions on Fund Flows

Variables	(1)	(2)	(3)	(4)	(5)	(6)
	FE			Fama_Macbech		
	CH3	CH4	Q	CH3	CH4	Q
l_return	0.933***	0.935***	0.633***	1.117***	1.094***	0.989***
	(7.121)	(6.833)	(4.647)	(7.278)	(6.968)	(7.381)
l_MarketState	-0.0378***	-0.0373***	-0.0437***	0.0193	0.0209	0.0104
	(-5.574)	(-5.158)	(-5.123)	(0.622)	(0.708)	(0.343)
RetState	-0.203	-0.237	0.00463	-0.406*	-0.476**	-0.495*
	(-1.503)	(-1.645)	(0.0189)	(-1.806)	(-2.173)	(-1.857)
l_FundAge	-0.566***	-0.567***	-0.560***	-0.00302*	-0.00301*	-0.00294*
	(-7.040)	(-7.091)	(-6.706)	(-1.768)	(-1.755)	(-1.712)
l_Volatility	0.126	0.111	0.290	-0.416*	-0.405*	-0.462*
	(0.514)	(0.454)	(1.255)	(-1.795)	(-1.776)	(-1.941)
l_FeeRatio	54.34***	54.30***	54.04***	52.22***	52.19***	51.65***
	(4.334)	(4.324)	(4.327)	(5.822)	(5.814)	(5.713)
l_lnFamTNA	-0.000666	-0.000493	-0.00140	0.00289	0.00298	0.00323
	(-0.0797)	(-0.0593)	(-0.169)	(1.440)	(1.487)	(1.507)
l_Turnover	-0.0272*	-0.0272*	-0.0264	-0.0539***	-0.0541***	-0.0521***
	(-1.692)	(-1.689)	(-1.641)	(-4.417)	(-4.423)	(-4.261)
Constant	3.023***	3.024***	3.005***	-0.289***	-0.294***	-0.291***
	(5.952)	(6.002)	(5.774)	(-3.499)	(-3.570)	(-3.331)
Observations	71,172	71,172	71,172	71,408	71,408	71,408
R-squared	0.150	0.150	0.147	0.118	0.118	0.117
Quarter FE	Y	Y	Y			
Fund FE	Y	Y	Y			

***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively; t-values are reported in parentheses.

2) The impact of extreme market conditions on the relationship between fund flows and performance

Table 9 reports the robustness test results for the moderating effect of extreme market conditions after fund excess returns are recalculated using the CH3, CH4, and q-factor models. Overall, the main conclusions remain highly consistent with the benchmark regression results, which further confirms the robustness of the asymmetry in the performance–fund flow relationship under extreme market conditions.

Table 9: Robustness Tests of the Moderating Effect of Extreme Market Conditions

Variables	(1)	(2)	(3)	(4)	(5)	(6)
	FE			Fama_Macbech		
	CH3	CH4	Q	CH3	CH4	Q
l_return	0.688***	0.648***	0.607**	0.696***	0.602***	0.460**
	(4.101)	(3.891)	(2.238)	(3.757)	(3.497)	(2.197)
l_RightTail	0.0187	0.0218	0.0489*	-0.0972	-0.0886	0.103
	(1.108)	(1.267)	(1.909)	(-0.884)	(-0.751)	(1.025)
l_LeftTail	0.0179	0.0159	-0.0159	0.203*	0.217*	0.148
	(0.987)	(0.872)	(-1.029)	(1.885)	(1.978)	(1.488)
RetRightTail	0.513**	0.535**	0.0694	2.075*	2.248*	-0.141

Variables	(1)	(2)	(3)	(4)	(5)	(6)
	FE			Fama_Macbech		
	CH3	CH4	Q	CH3	CH4	Q
	(2.459)	(2.324)	(0.234)	(1.764)	(1.710)	(-0.144)
RetLeftTail	-0.358***	-0.342***	-0.559***	0.929	1.361	0.0841
	(-3.364)	(-3.282)	(-2.850)	(1.213)	(1.468)	(0.0947)
l_FundAge	-0.565***	-0.565***	-0.559***	-0.00269	-0.00271	-0.00268
	(-6.980)	(-7.015)	(-6.734)	(-1.245)	(-1.249)	(-1.228)
l_Volatility	0.149	0.134	0.272	-0.450	-0.433	-0.531*
	(0.625)	(0.562)	(1.132)	(-1.648)	(-1.636)	(-1.756)
l_FeeRatio	54.61***	54.63***	54.15***	52.25***	52.28***	51.87***
	(4.375)	(4.371)	(4.347)	(6.544)	(6.507)	(6.273)
l_lnFamilyTNA	-0.000940	-0.000734	-0.00158	0.00295	0.00308	0.00329
	(-0.112)	(-0.0881)	(-0.190)	(1.458)	(1.527)	(1.528)
l_Turnover	-0.0282*	-0.0282*	-0.0267	-0.0536***	-0.0538***	-0.0522***
	(-1.756)	(-1.754)	(-1.671)	(-4.230)	(-4.200)	(-4.028)
Constant	2.987***	2.985***	2.963***	-0.271***	-0.275***	-0.280***
	(5.832)	(5.876)	(5.712)	(-4.081)	(-4.226)	(-4.166)
Observations	71,172	71,172	71,172	71,408	71,408	71,408
R-squared	0.151	0.151	0.147	0.125	0.125	0.123
Quarter FE	Y	Y	Y			
Fund FE	Y	Y	Y			

***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively; t-values are reported in parentheses.

4.3.3 Robustness Tests of the Effect of Market Sentiment on the Fund Flow–Performance Relationship

1) The impact of general market sentiment on the relationship between fund flows and performance

Table 10 reports the robustness test results for the effect of general market sentiment on the relationship between fund flows and performance. The regression results show that, regardless of whether the China-specific CH3 and CH4 factor models or the q-factor model is used, both the significance and the sign of the interaction term remain consistent with the benchmark analysis. This further strengthens the conclusion that the moderating effect of market sentiment on investors' fund selection behavior is robust and reliable.

Table 10: Robustness Tests of the Effect of Market Sentiment on Investors' Fund Selection Ability

Variables	(1)	(2)	(3)	(4)	(5)	(6)
	FE			Fama_Macbech		
	CH3	CH4	Q	CH3	CH4	Q
l_return	0.778***	0.754***	0.475***	-0.164	-0.274	-0.625
	(10.02)	(9.787)	(6.491)	(0.462)	(1.356)	(1.424)
l_sent	-0.0882	-0.0888	-0.0955	-0.265	-0.451	-0.534
	(-0.770)	(-0.779)	(-0.845)	(0.523)	(0.541)	(0.575)
RetSent	0.154**	0.169***	0.213***	0.946**	0.730**	0.884*
	(2.343)	(2.613)	(4.139)	(2.443)	(1.970)	(1.714)
l_FundAge	-0.568***	-0.569***	-0.562***	-0.00310	-0.00311	-0.00295
	(-7.564)	(-7.581)	(-7.498)	(0.00225)	(0.00227)	(0.00226)
l_Volatility	0.200	0.180	0.381***	-0.394	-0.392	-0.356
	(1.354)	(1.203)	(2.650)	(0.282)	(0.275)	(0.285)
l_FeeRatio	54.01***	53.95***	53.83***	50.95***	50.92***	50.79***
	(16.21)	(16.16)	(16.07)	(8.030)	(7.990)	(8.126)
l_lnFamilyTNA	-0.000309	-8.99e-05	-0.000991	0.00354*	0.00364*	0.00394*
	(-0.0408)	(-0.0118)	(-0.130)	(0.00204)	(0.00204)	(0.00219)
l_Turnover	-0.0261***	-0.0261***	-0.0254***	-0.0524***	-0.0527***	-0.0508***
	(-3.266)	(-3.259)	(-3.151)	(0.0127)	(0.0126)	(0.0128)
Constant	3.062***	3.062***	3.044***	0.168	0.222	0.778
	(6.020)	(6.025)	(5.998)	(0.516)	(0.569)	(0.615)

Variables	(1)	(2)	(3)	(4)	(5)	(6)
	FE			Fama_Macbech		
	CH3	CH4	Q	CH3	CH4	Q
Observations	71,172	71,172	71,172	71,408	71,408	71,408
R-squared	0.149	0.149	0.146	0.128	0.127	0.128
Quarter FE	Y	Y	Y			
Fund FE	Y	Y	Y			

***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively; t-values are reported in parentheses.

2) The impact of extreme market sentiment on the relationship between fund flows and performance

Table 11 reports the robustness test results for the moderating effect of extreme market sentiment after fund excess returns are recalculated using the CH3, CH4, and q-factor models. The results show that, after remeasuring fund performance, the asymmetric moderating effect of extreme market sentiment remains robust: extremely optimistic sentiment significantly strengthens the positive relationship between performance and fund flows, whereas extremely depressed sentiment weakens this relationship. These findings provide strong support for the reliability of the previous conclusion regarding the heterogeneity of investors' fund selection behavior under extreme sentiment conditions.

Table 11: Robustness Tests of the Effect of Extreme Market Sentiment on Investors' Fund Selection Ability

Variables	(1)	(2)	(3)	(4)	(5)	(6)
	FE			Fama_Macbech		
	CH3	CH4	Q	CH3	CH4	Q
l_return	0.849***	0.842***	0.615***	0.995**	0.872*	0.376
	(14.97)	(14.46)	(10.68)	(0.462)	(0.456)	(0.386)
l_sentRight	0.0101	0.00500	0.0214*	0.129	-0.294	-0.0224
	(0.817)	(0.392)	(1.853)	(0.227)	(0.200)	(0.117)
l_sentLeft	0.0135	0.0150	0.0123	-0.0611	-0.0557	-0.0676
	(0.930)	(1.035)	(0.824)	(0.0794)	(0.0815)	(0.0713)
RetSentLeft	-0.180	-0.224*	-0.135	-0.526*	-0.200*	-1.303
	(-1.401)	(-1.742)	(-1.570)	(2.371)	(2.050)	(0.856)
RetSentRight	0.548***	0.556***	0.622***	-5.127***	8.774***	0.116
	(3.932)	(3.771)	(5.218)	(4.860)	(8.392)	(0.564)
l_FundAge	-0.547***	-0.548***	-0.539***	-0.00311	-0.00312	-0.00300
	(-7.265)	(-7.275)	(-7.241)	(0.00226)	(0.00228)	(0.00227)
l_Volatility	0.0795	0.0541	0.246*	-0.416	-0.419	-0.379
	(0.515)	(0.345)	(1.668)	(0.288)	(0.280)	(0.284)
l_FeeRatio	51.06***	51.02***	51.05***	51.47***	51.40***	51.30***
	(15.72)	(15.62)	(15.75)	(8.059)	(8.032)	(8.136)
l_lnFamilyTNA	-0.000581	-0.000215	-0.00103	0.00311	0.00319	0.00354
	(-0.0779)	(-0.0289)	(-0.137)	(0.00198)	(0.00197)	(0.00214)
l_Turnover	-0.0245***	-0.0244***	-0.0238***	-0.0526***	-0.0528***	-0.0513***
	(-3.141)	(-3.130)	(-3.038)	(0.0128)	(0.0128)	(0.0129)
Constant	3.061***	3.061***	3.012***	-0.138	-0.140	-0.127
	(6.091)	(6.081)	(6.057)	(0.115)	(0.116)	(0.114)
Observations	66,365	66,365	66,365	71,408	71,408	71,408
R-squared	0.146	0.146	0.144	0.116	0.116	0.115
Quarter FE	Y	Y	Y			
Fund FE	Y	Y	Y			

***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively; t-values are reported in parentheses.

5. CONCLUSION

Based on data from China's public mutual fund market, this paper systematically examines the mechanisms

through which historical fund performance, market conditions, and market sentiment affect investors' capital allocation behavior. Using both fixed-effects models and the Fama–MacBeth approach, the empirical analysis yields the following main conclusions.

First, historical fund performance has a significantly positive effect on fund flows. Funds with better performance are more likely to attract subsequent capital inflows, indicating that performance-chasing behavior is widespread among investors in China's fund market. To some extent, capital allocation reflects investors' responses to historical return information.

Second, market conditions play a significant moderating role in the relationship between performance and fund flows. During favorable market periods, investors' sensitivity to fund performance declines. Under extreme market conditions, however, this relationship exhibits clear asymmetry: when the market rises sharply, the effect of performance is strengthened, whereas during periods of severe market decline, investors become more risk-averse and the importance of performance signals is significantly weakened.

Third, market sentiment is an important behavioral factor affecting investors' capital allocation. A rise in overall market sentiment significantly strengthens the promoting effect of performance on capital inflows, whereas extremely pessimistic sentiment weakens investors' tendency to allocate capital based on historical performance. This suggests that investor decisions are driven not only by fundamental information but also by psychological factors in a systematic way.

Overall, fund flows reflect not only investors' responses to performance information, but also the joint influence of market conditions and changes in sentiment. From the perspective of behavioral finance, this paper reveals the context-dependent characteristics of capital allocation in a market dominated by individual investors in China, and provides new empirical evidence for understanding the mechanisms of fund flows in the mutual fund market.

REFERENCES

[1] Ippolito, R.(1992).Consumer reaction to measures of poor quality :evidence from the mutual fund industry. Journal of Lawand Economics,35,45-70.
[2] Gruber, Martin J.,1996, Another puzzle: The growth inactively managed mutual funds, Journal of Finance 51,783–810.
[3] Chevalier, J., & Ellison, G. (1997). Risk Taking by Mutual Funds as a Response to Incentives. Journal of Political Economy, 105(6), 1167–1200.
[4] Sirri, E. R., & Tufano, P. (1998). Costly Search and Mutual Fund Flows. The Journal of Finance, 53(5), 1589–1622.
[5] Ferreira, M. A., Keswani, A., Miguel, A. F., & Ramos, S. B. (2010). The Flow-Performance Relationship Around the World. SSRN Electronic Journal. https://doi.org/10.2139/ssrn.1364062
[6] Guo, J., & Schönleber, L. (2020). Prospect Theory and Mutual Fund Flows. SSRN Electronic Journal.
[7] Cheng, I.-H., Hong, H., & Scheinkman, J. A. (2024). Climate sentiment and financial markets. Review of Financial Studies, 37(1), 1–45.
[8] Sirri, E. R., & Tufano, P. (1998). Costly Search and Mutual Fund Flows. The Journal of Finance, 53(5), 1589–1622.
[9] [9] Li Yao, Yu Jinjie. External effects of open-ended fund redemption mechanism [J]. Financial Research, 2004, (12): 111-120.
[10] Shu Jinghong. An empirical study on the redemption phenomenon of open-ended funds [J]. Quantitative Economics and Technological Economics Research, 2005, (04): 117-126.
[11] Lu Rong, Chen Baizhu, Xu Longbing, et al. Fund performance and investor choice - A study on the abnormal phenomenon of redemption in Chinese open-ended funds [J]. Economic Research, 2007, (06): 39-50.
[12] Wang Huijian, Zhang Bing, Zhou Anning. An empirical study on the anomaly of redemption in Chinese open-ended funds [J]. Southern Economy, 2007, (08): 65-73.
[13] Feng Jinyu. Is there no “redemption anomaly” in the domestic fund market? -- Based on the perspective of fund performance and capital flow [J]. Securities Market Herald, 2012, (12): 67-74.
[14] Wang Zebo, Wang Xing. An empirical study on “redemption anomaly” in my country’s open-ended funds -- based on Baidu Index as attention [J]. Economic Research Guide, 2017, (16): 80-84+86.
[15] Xiao Jihui. The impact of fund performance on investors’ subscription and redemption behavior: considering evidence from stock market performance [J]. Auditing and Economic Research, 2016, 31(04): 89-100.Wu,

Y. & Zhang, X. (2024) Investor sentiment and mutual fund flow-performance sensitivity: Evidence from China. Accounting & Finance, 64(Suppl. 1), 5133–5167.
[16] Kahneman, D. and Tversky, A. (1979) Prospect Theory: An Analysis of Decision under Risk. Econometrica: Journal of the Econometric Society, 47, 263-291.
[17] Baker, M., & Wurgler, J. (2006). Investor sentiment and the cross-section of stock returns. Journal of Finance, 61(4), 1645–1680.
[18] Wen, T., Zhang, B., & Zhang, X. (2021). The Impact of Market Sentiment on Fund Flow. Advances in Economics, Business and Management Research, 190.
[19] Wang, J., Wang, X., Yang, J., & Zhuang, X. (2020). Impact of investor sentiment on mutual fund risk taking and performance: evidence from China. Enterprise Information Systems, 14(6), 833–857.
[20] Song, Z., Gong, X., Zhang, C., & Yu, C. (2023). Investor sentiment based on scaled PCA method: A powerful predictor of realized volatility in the Chinese stock market. International Review of Economics & Finance, 83, 528–545.
[21] Song, Z., & Yu, C. (2022). Investor sentiment indices based on k-step PLS algorithm: A group of powerful predictors of stock market returns. International Review of Financial Analysis, 83, 102321.
[22] Yi Zhigao, Mao Ning. A study on the measurement of investor sentiment in the Chinese stock market: the construction of CICSI [J]. Financial Research, 2009, (11): 174-184.
[23] Kaplanski, G., & Levy, H. (2010b). Sentiment and Stock Prices: The Case of Aviation Disasters. Journal of Financial Economics, 95, 174-201.
[24] Liu, J., Stambaugh, R., & Yuan, Y. (2019). Size and value in China. Journal of Financial Economics.
[25] DeMiguel V, Gil-Bazo J, Nogales F J, et al. Machine learning and fund characteristics help to select mutual funds with positive alpha[J]. Journal of Financial Economics, 2023, 150(3):103737.
[26] Lan C. The efficacy of market timing and value creation[J]. Journal of Financial Research, 2024, 48(3):1032-1066.