Wealthy investors and financial advice: Variations in self and social perceptions.

Draft extended abstract

Ylva Baeckstrom* and Jo Silvester†

* PhD Student, Management Department, Cass Business School & TIAS School for Business and Society. Email:
ylva.baeckstrom.1@cass.city.ac.uk
† Management Department, Cass Business School, City University London UK. Email:
Jo.Silvester.1@city.ac.uk

ABSTRACT

We examine self and social perception for wealthy individual investors and their financial advisers. Our study explores variations in how investors judge their own investment risk tolerance, knowledge and confidence, and analyses how these are attributed to investors' personal characteristics and compare how investor self-ratings translate into asset allocation in existing investment portfolios. Social perception is tested through exploring how investors feel understood by their financial advisers. Our findings highlight differences in self-ratings between investors who receive professional investment advice and those who make their own investment decisions.

1. INTRODUCTION

Evidence that investors generally tend to imperfectly follow rational economic models through applying psychology to their investment decisions is well documented. Heuristics and biases affect human judgment (Gilovich, Griffin and Kahneman, 2002) with the maximisation of economic utility restricted by investor mistakes (Rabin, 1998). Groups of investors both perceive investments differently and make dissimilar decisions on what to invest in. For example, female investors have been found to be relatively less risk tolerant, less knowledge, and display less confidence in their investment decision than men (Barber and Odean, 2001, 2002; Croson and Gneezy, 2009; Charness and Gneezy, 2012). Lower self-rated risk tolerance has been argued to translate into investment behaviour such as smaller allocation to risky assets in portfolios held by female investors relative to male investors (Agnew *et al.*, 2008).

However, some investors, particularly those wealthy, do not make investment decisions in isolation but instead employ an agent, or financial adviser, to assist with information and advice and who influences investment decisions in delegated portfolio management (Stracca, 2006). Although evidence of the benefits of advice on investment performance is inconclusive and limited, researchers describe how professional advisers, albeit to a lesser extent than investors, also suffer from biases which result in less than desired improvements in investment decisions and portfolio returns (Glaser, Weber and Langer, 2010; De Bondt, 1998; Mullainathan, Nöth and Schoar, 2010). A recent study by Baeckstrom, Silvester and Pownall (2016) extended these finding to show how financial advisers who look after wealthy investors understand male and female investors differently. Relative to male investors, female investors were judged by advisers to have less control over their investments and thus be more dependent of their adviser. The gender of the adviser was also found to be important with female advisers rating both male and female investors to be less knowledgeable compared to male advisers.

Arguably, further consideration is needed to understand the impact that human judgement and biases can have in situations where such an adviser is engaged. The present addresses the need by further integrating social psychology and by drawing on self-perception theory, which concerns how people make sense of themselves (Bem, 1972), and social perception theory which addresses how people are observed by others (Nisbett and Ross, 1980). The research draws on these theories in order to develop understanding of investors and their financial advisers.

We expand the earlier findings by exploring self and social perceptions for investors who engage financial advisers and those who do not as well as gender differences. Using a unique data set of 980 wealthy investors, 72% of whom employ a financial adviser, we compare how investors understand themselves as investors and how they feel understood by their advisers. Through investor self-ratings, our study tests previous findings that women are more risk averse, less confident and have a lower level of knowledge about investments. We compare differences in self-ratings between investors who employ an adviser and those who make investment decisions in isolation. Social perception is tested through asking how much investors feel understood by their financial advisers, taking both the gender of the investor and the adviser into account with an overall comparison to the asset allocation in existing investment portfolios.

2. HYPOTHESES DEVELOPMENT

Literature shows differences in the characteristics of those who do and those who make investment decisions in isolation. Younger, overconfident, high income and male investors are less likely to seek advice with female, older, less financially literate and less risk tolerant investors more likely to seek advice (Bluethgen, et al., 2008; Karabulut 2011; Campbell, 2006; Lusardi and Mitchell, 2007; Guiso and Japelli, 2006). We test this through exploration of the following hypotheses:

Hypothesis 1: Relative to investors who employ an investment adviser, investors who make their own investment decisions are more likely to be:

1a) younger,

1b) male,

1c) willing to take a higher amount of investment risk,

1d) have more confidence in their investment decisions,

1e) have more knowledge about their investment decisions.

Following from previous findings that, relative to male investors, female investors have lower risk tolerance, are less financially literate and have a lower level of confidence about their investment decisions (Barber and Odean, 2001, 2002; Croson & Gneezy, 2009; Charness & Gneezy, 2012; Loibl and Hira, 2007), we investigate self-ratings made by investors in the following hypotheses:

Hypothesis 2. Relative to the male investors, female investors will rate themselves to:

2a) be willing to take a lower amount of investment risk.

2b) have less confidence in their investment decisions.

2c) have less knowledge about their investment decisions.

Little academic research has considered how investors feel understood by those who give them investment advice. However female investors have been identified to feel misunderstood by their advisers (Hewlett et al. 2014) and to be less satisfied with their advisors (Friedland 2013) suggesting that there are some gender differences. Considering the prevalence of wealthy individuals who employ professional advisers we explore social perception, i.e. how investors feel understood by their advisers through the following exploratory hypotheses:

Hypotheses 3a) Relative to male investors, female investors will be less satisfied with how their adviser understands their investment needs.

As actual investment behaviour is aligned to self-rated risk tolerance (Agnew *et al.*, 2008), we further hypothesise that there is a positive correlation between the allocation to risky assets in respondents' existing portfolio and their stated investment risk rating (Hypothesis 4).

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