IDEAS IN THE INSIGHT YOU CAN PUT INTO ACTION:

The findings reveal that investors who consult with financial planners have a higher probability of achieving better household investment portfolio performance than self-directed investors. Results also show that household income and investor's gender mediated the effect of information source on investment portfolio performance. This study is one of the first to provide empirical evidence of a positive relationship between the service that U.S. financial planners provide and their clients' financial outcome.

PRINCIPAL INSIGHTS:

Using national data that collect information on family finances, this study explored the relationship between investors' entire household investment portfolio's performance and the primary source where they obtain information when making retirement investment decisions. The primary information sources that individuals reported were either using a financial planner or being "self-directed." Self-directed refers to using information sources with little or no monetary cost, such as consulting with friends/relatives and/or a spouse/partner, conducting personal research or calling around, belonging to investment clubs, or accessing media.

Among the investors surveyed, 78% did not seek professional assistance when making saving and investment decisions while 22% used financial planners. Investors who used financial planners achieved significantly higher returns than self-directed investors for the same level of investment risks they took in their investment portfolio.

The two groups had significantly different socio-economic characteristics. Compared to self-directed investors, those who used financial planners were older, wealthier and had higher education. Among investors who used financial planners, 69% were 45 years of age or older. On the other hand, only 58% of self-directed investors were 45 or older. Non-Hispanic white investors accounted for 81% of those who used financial planners and 71% of self-directed investors. The majority of investors (53%) who consulted with financial planners had at least a bachelor’s degree. However, only 38% of self-directed investors had similar education. Investors who used financial planners as their information source reported higher household incomes (average of $135,269) than self-directed investors (average of $87,602).

In addition, users of financial planners are more willing to withstand financial risks and are investing for longer-term financial goals than self-directed investors. Three-fourths of investors who consulted with financial planners reported at least an average level of risk tolerance,
while only 58% of self-directed investors reported similar levels of risk tolerance. A higher percentage of investors who used financial planners (42%) than self-directed investors (33%) were long-term investors, reporting an investment horizon of at least 5 years.

Among investors with the same socio-economic characteristics (such as age, gender, education level and income) and expectations (such as how willing they are to withstand financial risks and whether they are long-term investors), the use of a financial planner was significantly positively related to their investment portfolio performance. Results showed that, compared with self-directed investors, investors who used financial planners as an information source when making saving and investment decisions were 116% as likely to achieve better returns for the same level of financial risks they undertook.

Among self-directed investors, those in the highest income group were over 300% times as likely as those in the lowest income group to achieve better portfolio returns for taking the same level of financial risks. On the other hand, among investors who used financial planners, those in the highest income quartile were 151.1% as likely. Similarly, compared to self-directed male investors, self-directed female investors were 124% as likely to achieve better investment portfolio performance. In addition, among investors who used financial planners, females were 18.9% less likely than (i.e. 81.1% as likely as) males to achieve better portfolio performance.

In summary, results of this study revealed evidence that portfolio performance, as measured by the amount of return for the same level of financial risks, was better for investors who used financial planners than for self-directed investors. In addition, the relationship between information source and portfolio performance was partially differed by respondents’ income and gender. With their experience and expertise, financial planners should be able to identify useful and relevant information more efficiently than average investors. In contrast, investors who, whether unwilling or unable, do not regularly search for information are less efficient in such searches. Consequently, some investors are not fully informed at the point of decision making and the service of financial planners can help them fill the information void. The findings of this study have confirmed that the service of financial planners is positively related to a client’s financial life.

One result that is of concern is that females who used financial planners were less likely to achieve better returns with the same amount of financial risks taken in the portfolio than males who used financial planners. It is established in the literature that females are less risk tolerant than males. Investors with low risk tolerance reasonably limit themselves to products with low risks. Although low portfolio performance may be due to a lack of attention on the part of financial planners who helped construct the portfolios, another possible reason for the low performance could be lack of selection of higher-return investment products among people with low risk tolerance. This, in turn, would lead to under-diversified portfolios that are more likely to have a higher risk, which reduces the amount of return that the portfolios can achieve for the same level of financial risks taken.

Retirement investors and employer-sponsored retirement plan participants, if they manage their own investments without consulting with professionals, need to consider not only the amount of return for the level of financial risks taken in the portfolio, but also should consider their total portfolio including all investment assets. If they work with a financial planner or advisor, they should ask their financial professional to consider the performance of their entire investment portfolio. Doing this requires investors and their planners or advisors to have adequate knowledge of all of their assets. One area that is often overlooked in these discussions is the correlation between these assets (i.e. how
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closely these assets’ returns go up and down together), which can increase or decrease the risks the investors are exposed to. Employers who sponsor retirement plans should provide investor education to help their plan participants understand not only the performance of assets held within the retirement plan, but also that the retirement plan asset is a part of their total investment portfolio.

To learn more, visit the Retirement Income Institute at www.allianceforlifetimeincome.org/retirement-income-institute