Individual Investors and Direct Stock Ownership

By James B. Cloonan

What would the American Association of Individual Investors be without individual investors?

This is a question I asked myself several times after reading in The Economist of May 5, 1990, that "the individual who owns shares directly is becoming increasingly rare."

The article went on to discuss a downward trend in direct share purchases by individuals, stating: "Were these trends to continue, the last American to own shares directly would sell his last one in the year 2003."

Reading such a prediction would have made me very concerned for the future of AAII were it not for my distrust of projections based on curve-fitting and for my faith that there is a core of individual investors who would always want to manage part of their portfolios themselves, using individual stock purchases. This core may alternately grow and shrink, but I feel it will always be there.

Of course, AAII serves all individual investors, including those who use mutual funds, and we could shift our emphasis if everyone turned solely to mutual funds. However, I believe that an individual, if at all possible, should manage at least the domestic equity portion of his portfolio.

Decline is Bottoming

Fortunately, the 25-year-long gradual reduction inthe percentage of U.S. equities owned by individuals appears to be bottoming above 50%. The percentage of individuals' assets in equities also seems to be bottoming above 20%. For the first time in 26 years, individuals became substantial net buyers of stock in 1991.

AAII members have considerably more money in equities than the average individual, and the percentage is in a slight long-term upward trend above 30%. Demographic trends point to an aging of the population, and since older people save and invest more than the young, the long-term trend will be toward more savings and greater stock ownership by individuals.

While mutual funds are important, particularly for foreign stocks and many types of bonds, the individual who is willing to spend some time and do some work has many advantages over institutions when purchasing stocks directly. Individuals can invest in special situations that are too small for institutions to invest in; they can also invest in the stock of companies that are too small or too illiquid for large positions. With deep discount commissions of two cents to three cents a share and automatic execution systems that guarantee 1,000 shares at the minimum spread, execution costs today for individuals are no greater than those for institutions.

But managing your own portfolio requires some work and discipline. If you don't have the time, feel unsure, or tend to act emotionally, then mutual funds are clearly desirable.

The Long-Term Trend

Overall, it appears that individuals finally are increasing their holdings of common stock and will continue to do so. Cynics might say this predicts a bear market. We may well have a bear market in the short term, but long term the market will go up and reward individuals who invest in equities.

Whether individuals invest directly or through mutual funds, and whether the short-term market is up or down, AAII will be looking for more ways to help the individual investor.

James Cloonan is chairman of AAII. His column is his own opinion and does not necessarily reflect the views of the AAII Journal.