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Briefly Noted

Knowledge and Investing Styles Vary

A majority (55%) of surveyed investors with $10,000 or more invested in stocks, bonds or mutual funds described themselves as being "listeners" in a Wells Fargo/Gallup poll. Listeners seek out good investment advice and tend to follow it. Nearly a quarter (24%) of surveyed investors rarely look at their investments ("snoozers"), whereas just 10% use a hands-on approach and express confidence in their abilities ("pros").

Pros mostly described their knowledge of investing as deserving a grade of A or B. Their answers to questions about financial knowledge imply that the high grades are warranted. More than 70% of the pros correctly said riskier investments incur more volatile returns. They also correctly said that stocks have been the best-performing type of investment over the past 20 years. Respondents in this group are more likely to have larger portfolios ($100,000) and to be retired.

Listeners were less confident, with 42% assigning their financial knowledge a grade of A or B, 39% giving themselves a grade of C. They were more evenly split in terms of wealth and working versus retired. More women tended to describe themselves as listeners than men, however.

Both listeners and snoozers were more likely to answer at least one of the two questions about financial knowledge incorrectly. Many survey respondents incorrectly guessed which asset had the best returns over the past 20 years, with just 66% of listeners and 59% of snoozers saying stocks were the best-performing asset. Overall, just 46% of surveyed investors answered both questions correctly. Another 40% were only able to correctly answer one of the two questions.

A wealth differential was also evident among the investor groups. More than 70% of investors with portfolios of $100,000 or more answered both financial knowledge questions correctly. They were also more confident, with nearly half (48%) giving themselves an A or B grade. Slightly more than half (53%) of investors with portfolios of less than $100,000 correctly said that stocks realized the highest returns over the past 20 years. They were also less confident, with 29% giving themselves a D or F grade for investment knowledge.

"Investing Styles Vary Widely Among U.S. Investors," Lydia Saad; Gallup, October 11, 2017.

Why Gender Tolerances Toward Risk May Differ

Several studies have found gender differences in risk tolerance. Men, on average, exhibit more tolerance for risk in their financial decisions than women do. Past studies have not determined whether the difference is specifically due to gender or if it is due to other factors.

Researchers at Virginia Tech and the University of Missouri sought to determine whether other factors lead to or influence gender-related differences. They analyzed data from the 2013 Survey of Consumer Finances. Nearly 2,250 households included in the survey had a head of household who was not married or partnered. This national survey included a question asking respondents to describe how much financial risk they and their spouse/partner are willing to take when saving or making investments. The four response options range from taking "substantial financial risks" to earn substantial returns to "not willing to take any financial risks."

The results confirmed the findings of previous studies: men, in aggregate, are more risk tolerant than women are. Approximately three-quarters of the men reported having a high risk tolerance (20.3%) or some risk tolerance (56.3%). In contrast, only half of women reported having a high risk tolerance (11.4%) or some risk tolerance (39.6%).

Income uncertainty had the opposite effect on attitudes toward risk. Men who expected to have uncertain income were 95.6% more likely to have a high risk tolerance compared to men with no income uncertainty. Women, on the other, hand were 6.8% less likely to have a high risk tolerance relative to women with no income uncertainty. A similar pattern was observed for "some risk tolerance," with men being more likely to be risk tolerant and women being less likely.

On the other hand, increases in net worth had a larger, positive impact on women. A 10% increase in net worth led to a 4.6% increase in the odds of women having a high risk tolerance. For men, the same increase in wealth increased the odds of reporting a higher risk tolerance by just 1.7%.

The researchers observed lower average incomes for women. They found a higher percentage of women to have uncertain incomes from year-to-year. They theorize this may lead women to keep funds in low-return accounts to offset the risk of "negative income shocks."

Source: Gender Differences in Financial Risk Tolerance," Patti J. Fisher and Rui Yao; Journal of Economic Psychology, March 16, 2017.

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The Impact of Out-of-Pocket Medical Spending on Retiree's Income

A major cost for retirees is health care. Though most retirees over age 65 are enrolled in Medicare, out-of-pocket costs can still be significant. Premiums for Medicare Part B, Part D and supplemental coverage; cost-sharing for medical services; as well as dental and vision examinations and treatments are paid out of pocket. Long-term care for those not covered by Medicaid are also out-of-pocket expenditures.

An analysis of data included in the 2002–2014 waves of the Health and Retirement Study (HRS) was conducted to determine how much of retiree incomes these expenses accounted for. The HRS is a national study of American adults ages 50 and older. This particular analysis was limited to survey respondents ages 65 and older and who were collecting Social Security benefits.

Not surprisingly, out-of-pocket medical spending varied widely. The median amount spent in 2014 was $3,681 (meaning half of survey respondents spent more and half spent less). Out-of-pocket expenditures ranged from a little over $2,000 for those at the 25th percentile to nearly $10,000 at the 95th percentile. Spending on cost-sharing (e.g., co-pays) rose considerably at the higher percentiles, jumping by nearly 50% between the 90th and the 95th percentiles.

Relative to Social Security benefits, out-of-pocket medical costs account for a high percentage of income. The average retiree spends nearly a third of benefit payments on premiums and other out-of-pocket medical costs.

Many retirees are fortunate to have more than just Social Security benefits as a source of retirement income [pensions, 401(k) plans, savings, etc.] Still, medical costs consume a significant portion of income. In 2014, premiums and other out-of-pocket costs consumed 11.4% of the median retiree's total income. Notably, whether a retiree has retiree health insurance, a Medicare Advantage plan or only Medicare, the approximate percentage of income left over after out-of-pocket expenses are paid does not vary by much. Some of this is due to the relative differences in wealth and premiums.

Long-term care diminishes income, but not significantly. Respondents to the study's survey who either resided in a long-term care facility or had a spouse residing in a long-term care facility spent, on average, approximately 19% of income on out-of-pocket medical costs.

"How Much Does Out-of-Pocket Medical Spending Eat Away at Retirement Income?" Melissa McInerney, Matthew Rutledge and Sara Ellen King; Center for Retirement Research at Boston College Working Paper, October 2017.

Fund Manager Experience Does Not Predict Outperformance

Experience by itself does not predict whether or not a mutual fund manager will outperform in the future. Though mutual fund managers who have been the sole manager of their funds have as a group outperformed the benchmarks, a closer look finds both wide disparities in relative returns and the influence of other factors.

A professor at the University of London analyzed 357 U.S. equity funds run solely by one manager with a minimum of 10 years' tenure as of December 2014. The study encompassed the period of 2005 through 2014. In aggregate, these managers beat their benchmarks by an average of four basis points (0.04%) per month. This equates to a relative return advantage of nearly 50 basis points (0.5%) per year on a net-of-fee basis. The results reflect a survivor bias, meaning managers who were fired or funds that were closed or merged at some point during the 10-year period were excluded from the analysis.

Just 60% of the managers included in the analysis actually outperformed their benchmarks. The average returns relative to the underlying benchmark for all funds were negative for six of the 10 years studied. Four of the six disappointing years occurred during the last four years of the period analyzed.

There was also an "absence of positive performance persistence." Funds ranking in the bottom 10% of returns in one calendar year tended to have positive relative returns the following year. This pattern was found to occur in seven of the nine years studied. Furthermore, no consistent pattern of relative out- or underperformance was found to exist in the year-by-year returns.

There were a few traits found to be associated with higher relative returns. Funds holding more concentrated portfolios (meaning fewer stocks) and charging lower fees tended to perform better than funds with larger portfolios and higher fees. Larger funds in smaller fund families had higher relative returns than smaller funds in larger fund families. A value bias subtracted from outperformance, while a small-cap bias increased relative performance. (These last two factors may be due to the period studied, particularly to the extent that value strategies were out-of-favor relative to growth strategies.)

"The Performance of Long-Serving Fund Managers," Andrew Clare; International Review of Financial Analysis, July 8, 2017.