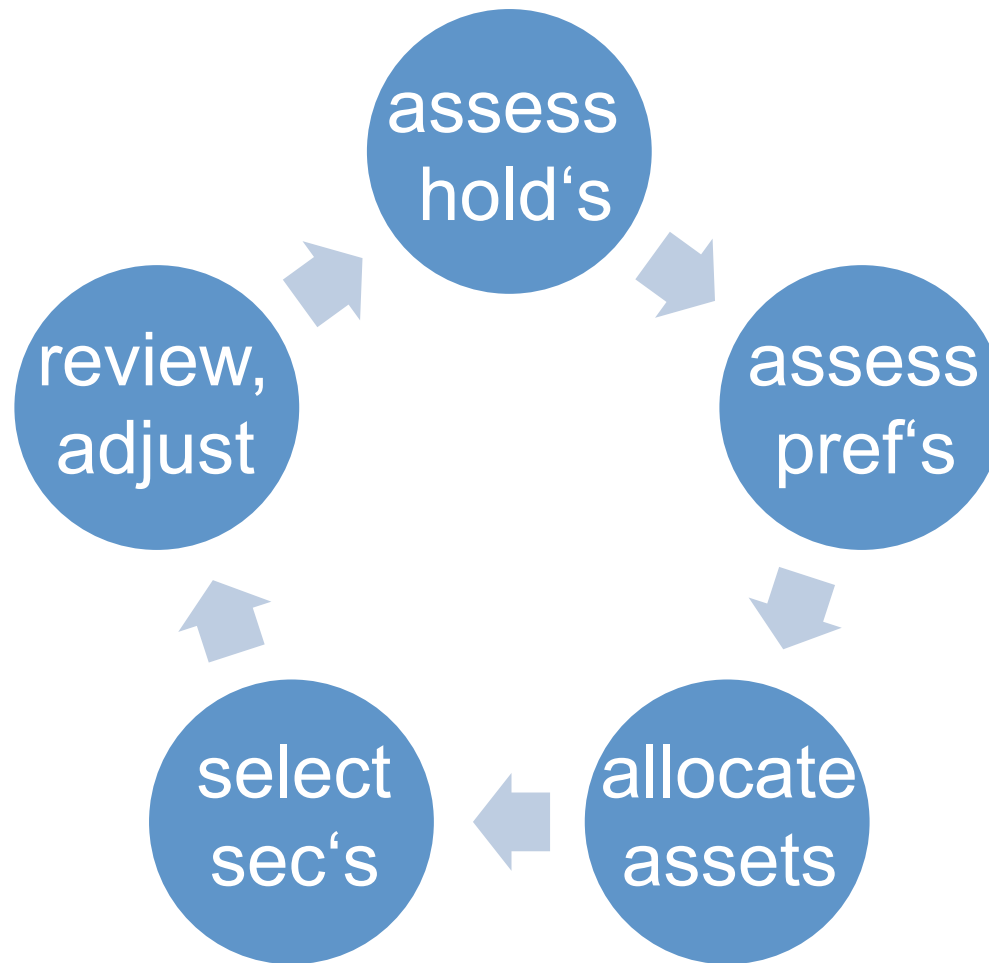


Financial Advice and Retail Investors

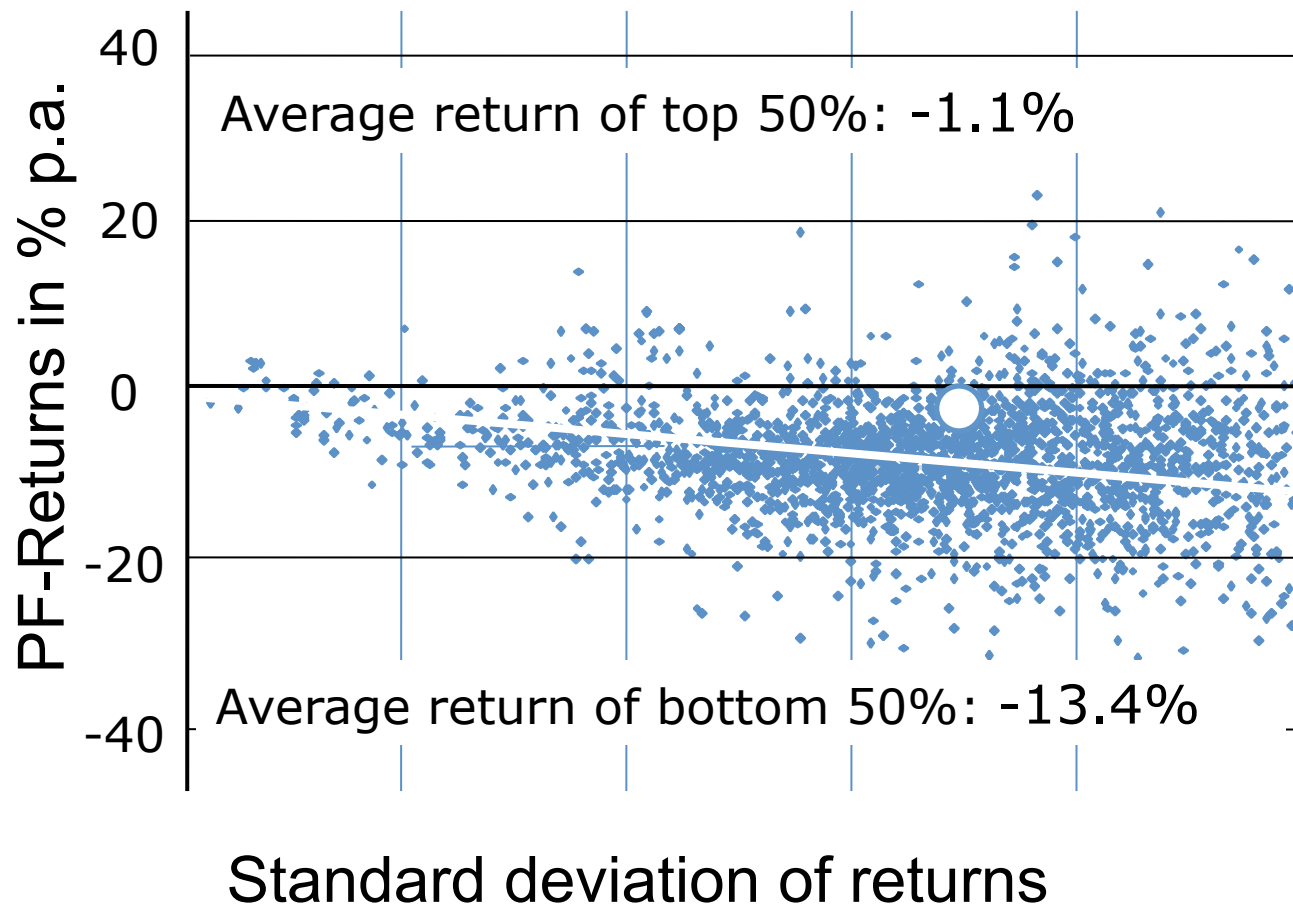
Andreas Hackethal & Roman Inderst
Goethe Universität Frankfurt am Main

Financial advice can help retail investors to better manage risk



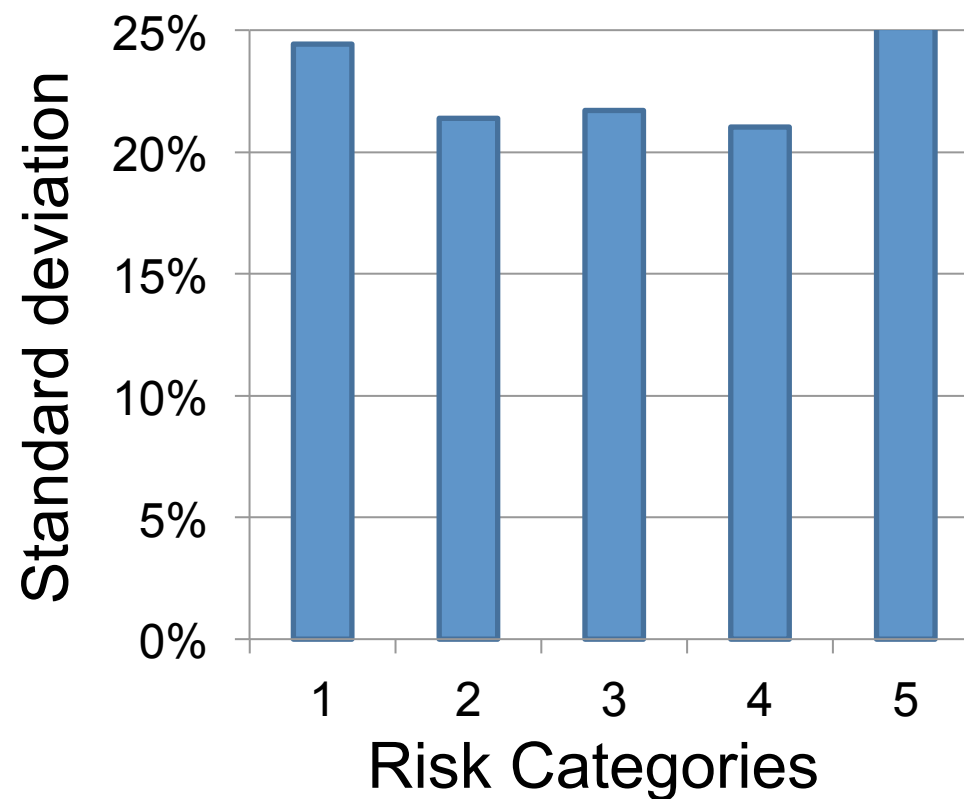
Observation 1: many retail investors hold inefficient portfolios

3,000 Portfolios of online broker clients (10/2005 - 4/2009)



Observation 2: actual portfolio risk not compatible with desired risk

14,000 customers of an online brokerage (2007-2008)



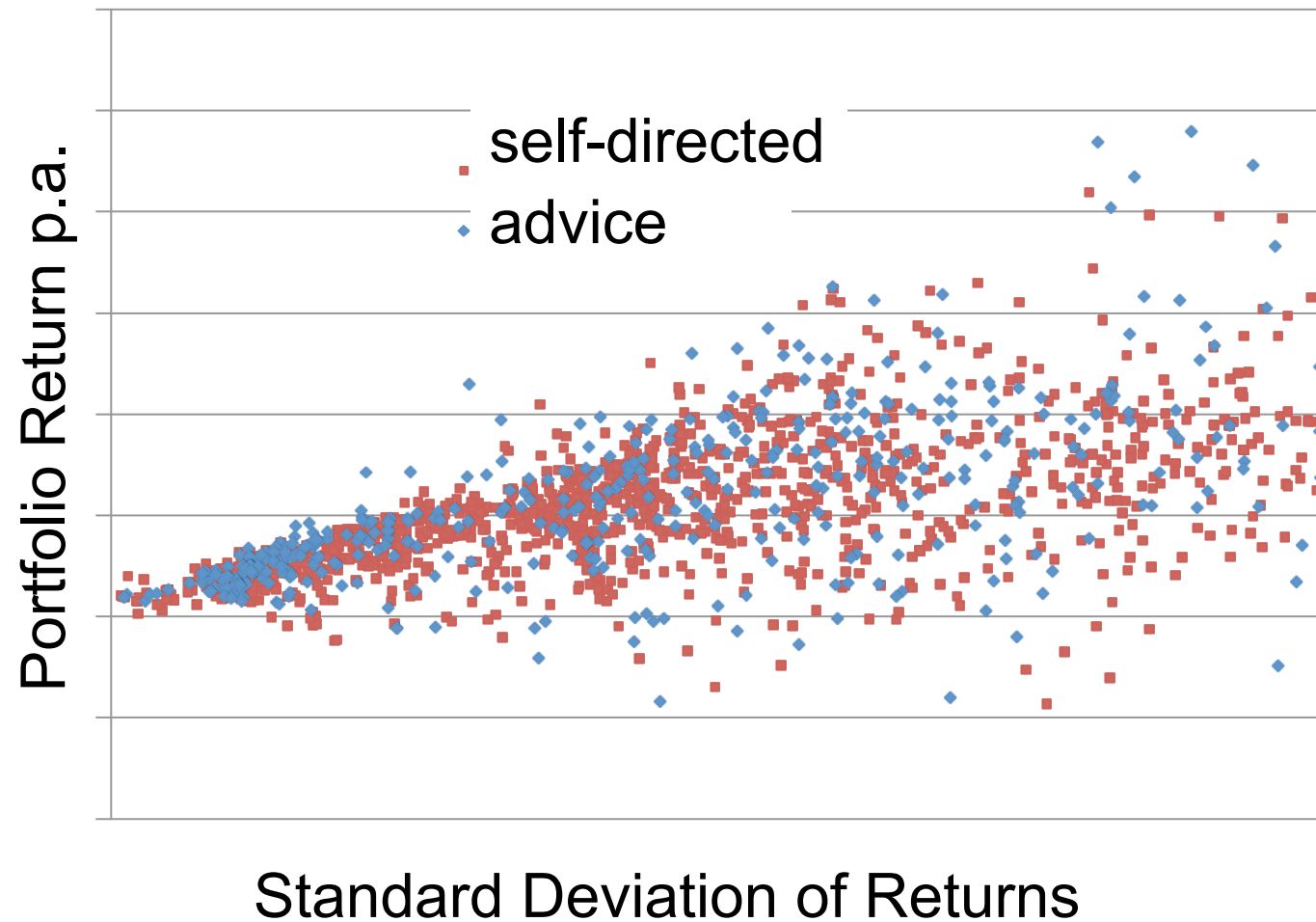
Source: Own data analysis

Four prototypical roles of advice

	Limited financial capabilities	Systematic biases, misperceptions
Incentives aligned	1 bridges knowledge gap	2 educates about systematic errors
Conflicts of interest	3 hides fees or risks	4 exploits misperceptions

Observation 3: Advice does not always exploit potential

Risk-Return Profiles of 2,147 bank clients (3/2003 - 2/2008)



Observation 4: lower Sharpe Ratios for advised clients at branch-based bank

Financial Advice and Sharpe Ratios







(2SLS: financial advice instrumented by local bank branch density)

	OLS estimates	2SLS estimates
Financial advisor	-0.159*** (0.0307)	-0.871*** (0.1245)
Male	-0.034 (0.0251)	-0.067*** (0.0090)
Overconfidence	-0.318*** (0.0178)	-0.383*** (0.0132)
Investor competence	-0.485*** (0.0551)	-0.431*** (0.0130)

Source: Karabulut (2012)

Observation 5: evidence consistent with conflicts of interest

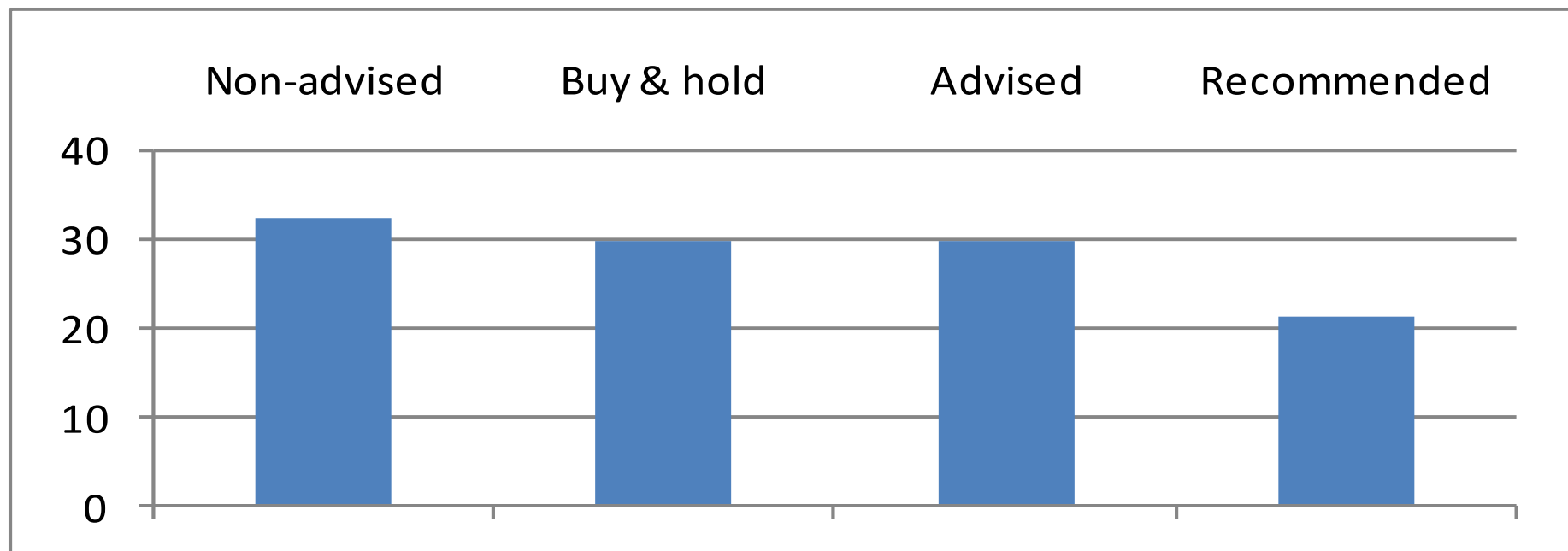
- 51,000 customers of an online brokerage (8 years of data)
- 83% male, account volume: €44,000, 3 transactions p.m.
- 663 customers switched into advisory model
- Difference-in-difference approach

Investment Mistakes	Experience	Advice
Underdiversification		
Disposition Effect		
Excessive Trading		

Source: Koestner (2012)

Observation 6a: beneficial advice does exist

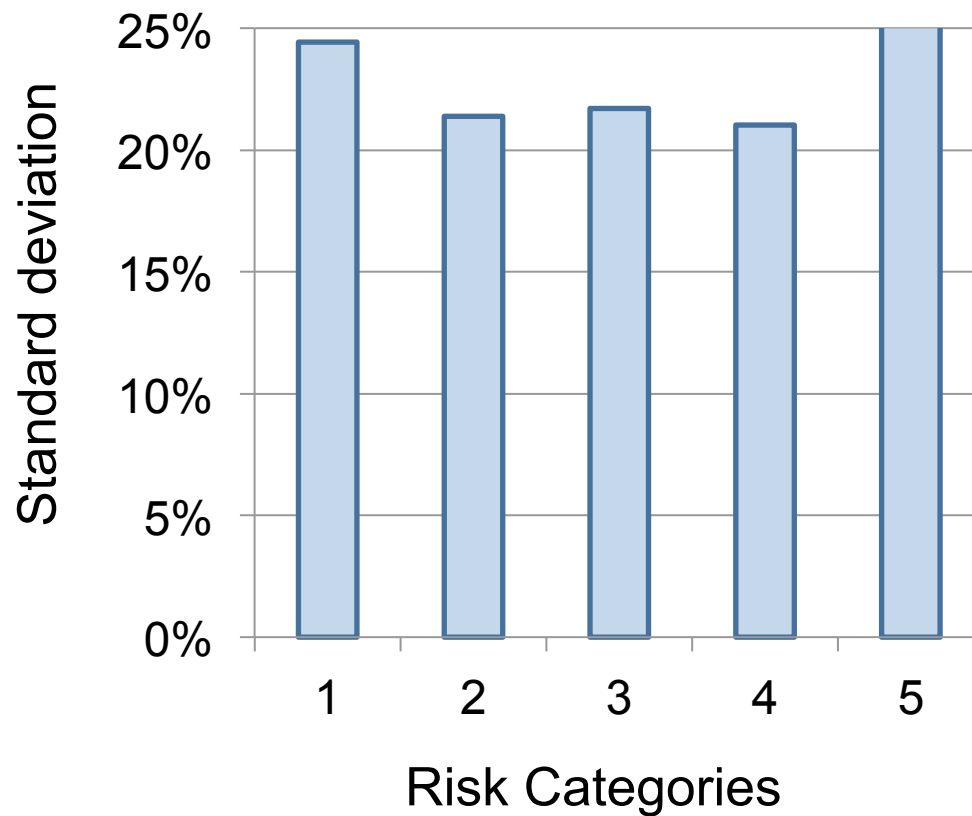
Unsystematic risk share in %



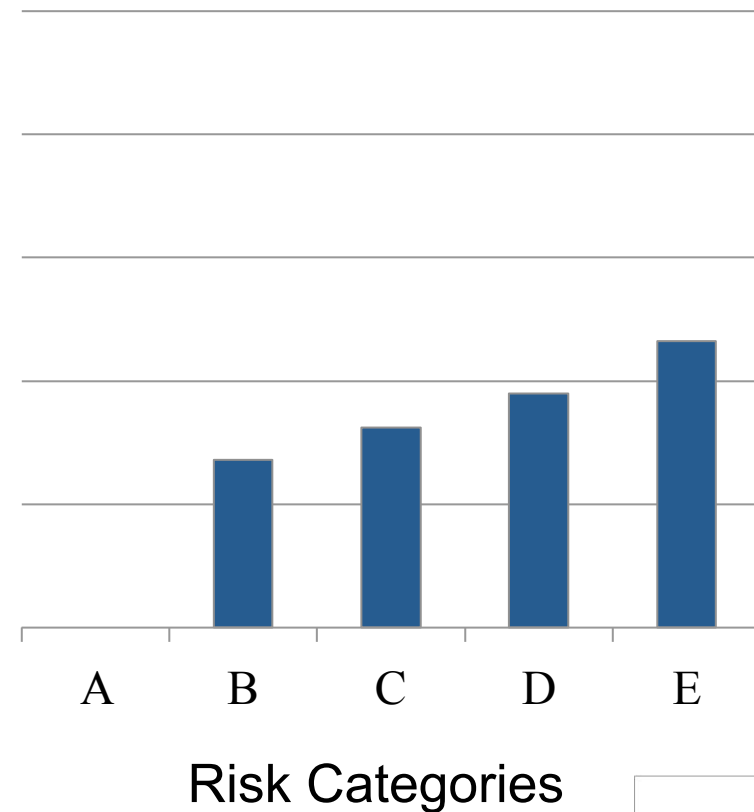
Source: Bhattacharya, Hackethal, Kaesler, Loos, Meyer (2012)

Observation 6b: beneficial advice does exist

Actual PFs of 14,000 customers of an online brokerage (2007-2008)

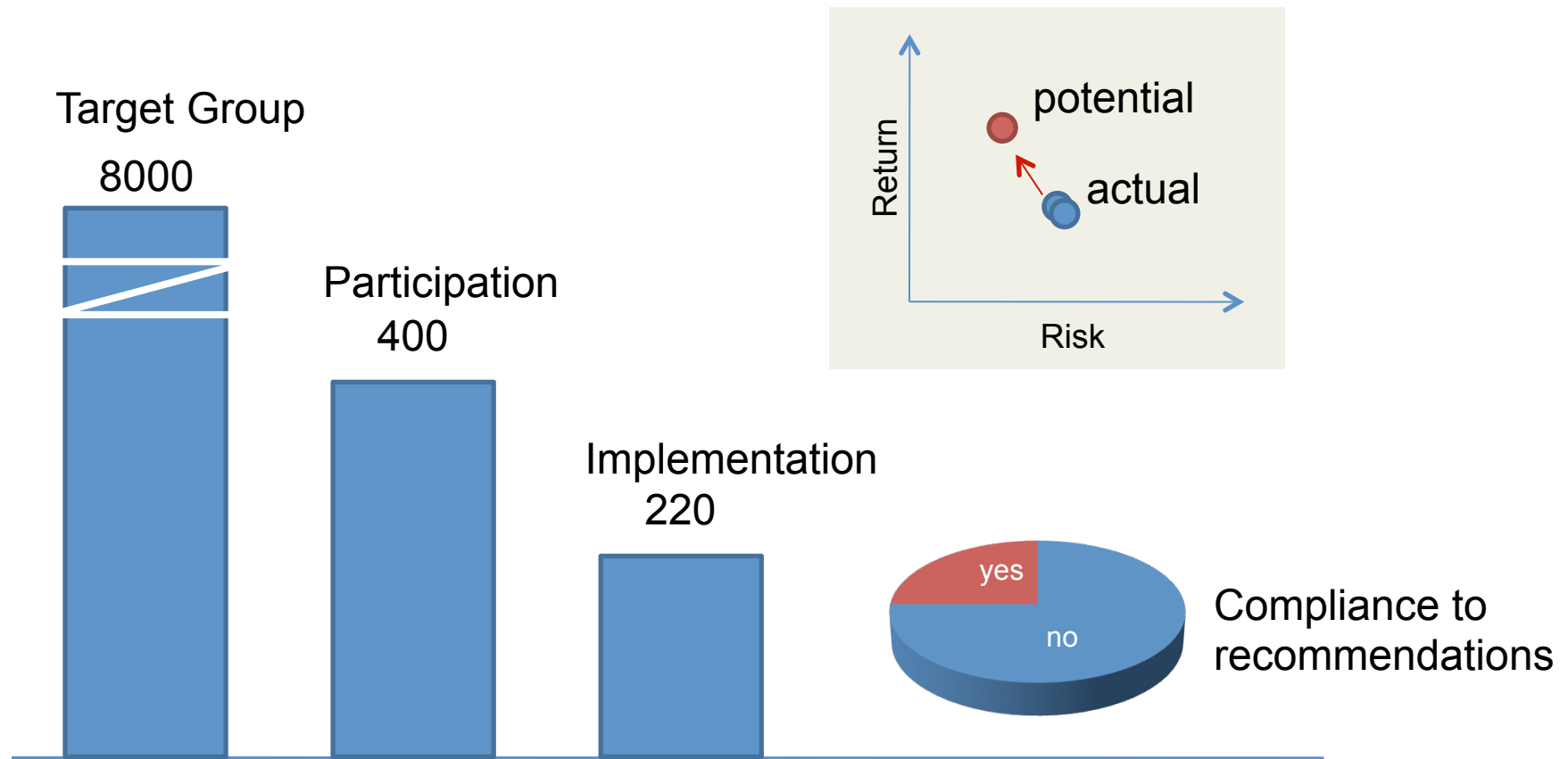


Recommended PFs for 400 advisory customers (2009)



Source: Own data analysis

Observation 7: beneficial advice not followed by retail investors



Source: Bhattacharya, Hackethal, Kaesler, Loos, Meyer (2012)

Tentative policy implications

	Limited financial capability	Systematic biases, misperceptions	
Aligned	1 bridges knowledge gap	2 educates about systematic errors	...but not followed
Conflicted	3 hides fees or risks	4 exploits misperceptions	...but not detected

- Regulatory initiatives attempt to eliminate types (3) and (4)
- However, types (1) and (2) not sufficient for better outcomes
- Complementary approach: more transparency regarding risk alignment and net return
- Call for standard vocabulary on portfolio risk
- Allows signaling of good advice

Some questions for future research

- Who seeks advice and why?
- How do advisors and consumers communicate about needs and results?
- What makes investors follow advice?
- How should risk and return be presented to investors?