Locus of Control and Investment in Equity

Nicolas Salamanca, Andries de Grip, Didier Fouarge, and **Raymond Montizaan**

Discussant: **Stefan Hochguertel** (VU Amsterdam)

International Pension Workshop Netspar

Leiden, January 18, 2017

Topical!

What this paper does

- relates household portfolio choice to psychology
- estimates models relating investment choices to a stable measure of the internal locus of control (ILOC)
- use exceptionally rich survey data that allow
  - measuring detailed household financial portfolios
  - over a long and very interesting period of time
  - assess personality traits, psychological concepts, and quantifies risk attitude and time preference

What this paper finds

- ILOC economically important for equity holdings over and above risk attitudes, financial literacy, and overconfidence
- main effect through negative influence of ILOC on risk perception
- not driven by financial literacy (but drops to half), not driven by observed investment experience
- not driven by trust, optimism, overconfidence, other traits

Commendations

- first and important step towards understanding personality determinants of household financial behavior
- expertly executed, well written, carefully done
- overall reasonably/quite stable estimates
- battery of sensible robustness checks (ME, defs, etc.)

What is ILOC?

- “The extent to which a person believes that the outcomes in his or her life are due to personal efforts, as opposed to the result of luck, change, fate, or the intervention of others”
- ILOC is assumed to be a stable personality trait that has crystallized after onset of adult life

Fixed-effects Assumption on Personality

- Heckman: personality traits change over LC
- "personal effort" in the definition, which may change with cognitive and non-cognitive skills and abilities as individuals age
- suggests: some more discussion on response to
  - life cycle events (divorce, widowhood, parenthood, etc.)
  - aging and health
  - success and failure in the stock / labor market

Overconfidence

- Intuitively constructed as deviation between “subjective” and “objective” measures of financial literacy
- is this a good indicator of overconfidence? (same dimension of personality?)

Why should ILOC matter?

- low-ILOC persons can use agents to do the investment for them (bank, broker), or rely on index trackers, without implying to invest less
- So, through which channel does this operate? What translates ILOC-trait into behav. action?
  - authors: risk perception
- What is the relation to self-employment?
- Correlated with emotional stability?
- Correlated with other behavioral biases and judgment failures, esp. procrastination / hyperbolic discounting

Data

- Models
  - DEQ = f(ILOC, and other stuff)
  - EQ/FW = g(ILOC and other stuff)
- Sample restrictions
  - 80 yo? (cognitive functions?)
  - not on DI? (asset means test?)
  - FW > 0 …?
  - Cash > 0 …?
- averaging: how many hh with 1 participation?

Risk Perception

- Test based on selling and buying options
  - nice approach
  - however, very few households trade options, they are not average households
  - lots of noise
  - conditional sample of equity holders

Policy Conclusions

- evidence elsewhere consistently shows that behaviorally-informed policy choices and nudges can be successfully and cost-effectively administered taking into account existing heterogeneity in the population along relevant margins
- what nudges can help people make better decisions for themselves in the present context? (financial advise, education, and information, calculators, warnings, reminders, defaults etc.)