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
  – $\text{DEQ} = f(\text{ILOC}, \text{and other stuff})$
  – $\text{EQ/FW} = g(\text{ILOC and other stuff})$

• Sample restrictions
  – 80 yo? (cognitive functions?)
  – not on DI? (asset means test?)
  – $\text{FW} > 0$ ...?
  – $\text{Cash} > 0$ ...?

• 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.)