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## **The demand for disability insurance** (pp. 1–12)

Janine K. Scott, Michael S. Finke

Disability insurance is a vital hedge against an unexpected loss in human capital, yet less than half of U.S. households own this type of insurance. This article explores factors that affect demand for disability insurance and investigates the impact of financial sophistication and professional financial advice on insurance ownership. Prior research shows that low financial knowledge, behavioral biases, and other barriers to purchase are related to low demand among households. Using the 2007 Survey of Consumer Finances, we find that demand for disability insurance increases with financial sophistication, the use of a financial advisor, and proxies for group insurance availability. Results indicate that low demand for disability insurance can be attributed to both demand and supply factors. © 2013 Academy of Financial Services. All rights reserved.

## **Socially responsible investing and student managed investment funds: Expanding investment education** (pp. 13–22)

John Clinebell

Social investing has grown to become a significant part of the investment world, but is still an often-ignored concept in investment education. This article discusses the history and trends in social investing and discusses how the concepts of social investing can be incorporated in student managed investment funds. Specifically, the design of a socially responsible investing student fund at one university is discussed. Although there are many challenges to overcome in integrating socially responsible investing in the finance curriculum, student managed investment funds may provide a useful vehicle for addressing the ethical and social issues faced in today's investment environment. © 2013 Academy of Financial Services. All rights reserved.

## **Financial risk tolerance: An analysis of unexplored factors** (pp. 23–50)

Ryan Gibson, David Michayluk, Gerhard Van de Venter

Using data from a survey alliance between Kiplinger's Personal Finance Magazine, PBS's Nightly Business Report, and FinaMetrica, this study explores various demographical and attitudinal factors related to financial risk tolerance. Investigating risk tolerance scores of more than 2,000 individuals immediately after the 2008 Global Financial Crisis, we find a positive relationship between risk tolerance and income, investment knowledge and positive stock market expectations. Risk tolerance is found to be lower for females, older individuals, those that currently use a financial advisor and individuals that perceive the stock market to be riskier than two years before. © 2013 Academy of Financial Services. All rights reserved.

## Optimal contribution strategy as a function of the optimal withdrawal decision making: Case of deductible IRA versus Roth IRA (pp. 51–75)

Andrei Shynkevich

The issue of the attractiveness of the deductible IRA versus Roth IRA is revisited by combining the contribution phase with the withdrawal phase in the analysis. Previous related studies ignore the important implication that the optimal withdrawal sequence first takes funds held in the taxable account followed by the withdrawals from the designated retirement account such as an IRA that will ultimately affect the decision about the optimal contribution strategy. The optimal contribution strategy is not affected by the expected length of the retirement horizon in the flat tax rate environment. In the presence of progressive taxes, the investor should contribute more to the Roth IRA if the retirement period is shorter and if he is more optimistic about the return his investments will produce. Required minimum distributions levied on the deductible IRA but not the Roth IRA do not materially affect the optimal contribution strategy. The decision to convert the funds at the existing deductible IRA to Roth IRA and the decision to start making contributions to a newly available Roth IRA do not necessarily point in the same direction: under some circumstances one should not convert yet make a contribution to the Roth account. © 2013 Academy of Financial Services. All rights reserved.

## Risk tolerance and demographic characteristics: Preliminary Irish evidence (pp. 77–91)

Charles Larkin, Brian M. Lucey, Megan Mulholland

We examine by means of a survey and subsequent statistical analysis the extent of financial risk tolerance in Irish adults. We administer the (Grable & Lytton, 1999) 13 item risk tolerance instrument, and find confirmed a number of stylized facts found elsewhere on age, gender, and education levels and their impact on risk tolerance. This is to our knowledge the first comprehensive survey of Irish adults on their risk tolerance. © 2013 Academy of Financial Services. All rights reserved.



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## **Risk-sharing implications for Roth IRA conversions: Fact and fiction**

**Stephen M. Horan, Ashraf Al Zaman**

We investigated the risk-sharing implications of taxation associated with the option to convert a traditional IRA to a Roth IRA. Although the conversion option creates value for savers by potentially reducing their tax burdens, the risk profile of their holdings may change as well. Delaying payment of the conversion tax creates a leveraged equity position for the taxpayer. We show that the conversion decision depends on the dynamics of the underlying asset, including volatility and its path through time. Moreover, how asset dynamics affect the ultimate payoff depends on the financing source for the conversion tax payment. These factors render some conventional wisdom around conversion unreliable. © 2013 Academy of Financial Services. All rights reserved.

## **Rationality, irrationality, and “predictable irrationality”: Does education, curriculum, or gender matter?**

**Robert C. Dolan, Jerry L. Stevens**

The behavioral finance literature suggests that ingrained biases block rational analysis by individual investors. In this study, we test for differences in a key investment bias across cohorts defined by college education, courses of study, and gender. We find that “predictable irrationality” because of a behavioral bias is a frequent and statistically significant response that is invariant with respect to college education or courses of study. Irrationality not linked to a behavioral bias varies with college education, courses of study, and gender. Men make more rational choices than women overall, but a college education eliminates the significance of the difference. © 2013 Academy of Financial Services. All rights reserved.

# The influence of race on the social security early retirement decision for married couples

Diane Docking, Rich Fortin, Stuart Michelson

There has been an extensive amount of research into the social security early and delayed retirement decision for married couples. The results have been mixed. This article extends the analysis of prior research to the early and delayed retirement decision for married men and women. We analyze the decision for married couples by race. More specifically, we analyze the nine married couple combinations for the following races: Whites (W), Hispanics (H), and Blacks (B). The nine husband/ wife combinations are: WW, BB, HH, WB, BW, WH, HW, BH, and HB. We develop an Excel model to compute the breakeven (BE) internal rate of return (IRR) for each of the nine race combinations from age 62 through age 70. The BE IRRs can be interpreted as follows: If a couple's opportunity cost of capital (that can be considered a hurdle rate) is greater than (less than) the computed BE IRR, the couple should retire at the earlier (later) age. This study is limited to same age couples and we compute the BE IRR starting: at age 62 for all other years through age 70, at age 63 for all other years through age 70, at age 64 for all other years through age 70 and so on. Our results are fairly uniformly consistent across the nine race combinations: BE IRRs for a given "base age" are, in general, monotonically decreasing compared with older ages (the exceptions are when comparing age 62 to ages 63, 64, and 65). We conclude that, from a given base age, it is generally more optimal to retire now with a longer time horizon because the hurdle rate is lower and later with a short time horizon because the hurdle rate is higher. © 2013 Academy of Financial Services. All rights reserved.

## Who takes personal finance?

Jaelyn J. Beierlein, Margot Neverett

Using a sample of 17,499 first-time, full-time students, we compare students who take an elective personal finance course to those that do not. Women, students with higher verbal SAT scores and GPAs, and arts and education majors are less likely to take the course, while men and business, human ecology, and social sciences majors are more likely. Mathematics SAT scores have no effect. Women earn slightly higher grades in the course than men do, on average. If enrollment can be considered a measure of interest, among traditional college students, women demonstrate less interest in personal finance than do men. © 2013 Academy of Financial Services. All rights reserved.

# Accumulating and spending retirement assets: A behavioral finance explanation

Diane K. Schooley, Debra Drecnik Worden

Increasing uncertainty surrounding social security benefits and public sector pension plans is pushing retirement savings into the spotlight. This study finds that education, financial discipline, and financial sophistication increase the likelihood of participating in a pension or an IRA/Keogh plan. Financial distress decreases the likelihood of setting aside additional funds in an IRA/Keogh plan. Further, the likelihood that an eligible individual will decline an offered pension plan decreases with education and financial discipline and financial sophistication. Controlling for health and marital status, the choice to annuitize retirement assets decreases with age and the desire to take risk. © 2013 Academy of Financial Services. All rights reserved.



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## Does it pay to realize tax losses at the year-end?

Adam Y.C. Lei, Huihua Li

Motivated by the widely touted practice, we examine the effects of realizing tax losses at the year-end on simulated stock portfolios. Our results indicate that the timing of portfolio formation, the cutoff that triggers the loss realization, the length of an investor's holding period, and to a lesser extent, the timing of the tax benefits, all affect the probability that the tax-loss strategy outperforms a simple buy-and-hold strategy. Collectively, our findings support the tax-loss strategy in general, but they also suggest that factors other than an investor's applicable tax rate affect the effectiveness of this strategy as well. © 2013 Academy of Financial Services. All rights reserved.

## Financial literacy of U.S. households: Knowledge vs. long-term financial planning

Yasser Alhenawi, Khaled Elkhal

We examine the relationship between financial knowledge and long-term financial planning behavior. This analysis is important in light of the recent financial crisis and the current level of economic uncertainty. Survey responses from U.S. households are analyzed using analysis of variance, subgroup analysis, and logistic regressions. Results show that surveyed households are financially knowledgeable (mean score is 75.1%), but exhibit poor financial planning skills (mean score is 59.8%). The findings also show that the correlation between knowledge and financial planning is low, albeit positive. To promote financial literacy, we suggest that public policies strive to embolden financial education during early stages of life; preferably during college years. © 2013 Academy of Financial Services. All rights reserved.

## Should personal finance be the first finance course?

Jaclyn J. Beierlein, Margot Neverett

We examine the effect that taking a college-level personal finance course has on students' performance in a concurrent or subsequent managerial finance course. Using institutional data for students in first time, full time cohorts for 2002–2006, we find that taking the finance courses concurrently appears to significantly increase the likelihood of earning a higher grade in or passing Financial Management, but that taking Personal Finance first does not. We conclude that taking the courses concurrently may be beneficial because it increases the time spent on complementary reading and homework, provides two perspectives on similar material, and increases focus on finance. © 2013 Academy of Financial Services. All rights reserved.

## Characteristics and performance of real return funds

Amy F. Lipton, Richard J. Kish

U.S. Treasury Inflation-Protected Securities (TIPS) are the primary security in real return mutual funds. This article focuses on a key question for investors: Do real return mutual funds add value to a portfolio or are they just redundant securities? We find that while some real return funds do provide a return in excess of the rate of inflation, their absolute and risk-adjusted returns are rarely better than a TIPS Index. Further, few of these funds provide investors with positive alpha after controlling for either their benchmarks or macroeconomic and systematic factors. © 2013 Academy of Financial Services. All rights reserved.

## Individual investors: □ Asset allocation vs. portfolio insurance (puts or calls)

Ken Johnston, John Halem, Elton Scott

The purpose of this study is to test if an individual can successfully use index options to partially replace fixed income securities in an individual's retirement portfolio. Two types of option insurance portfolios are examined. Put option insurance portfolios are created by selling fixed percentages of a stock index portfolio and using the proceeds to purchase index put options. Call option insurance portfolios are created by writing index options worth fixed percentages of a stock index portfolio and using the proceeds to purchase more of the stock index (covered call option insurance is also examined). The use of put options in the portfolio should allow the investor to reduce downside risk, as they age, similar to increasing the bond allocation, while also allowing the investor to participate in increased upside potential by having a higher percentage of the portfolio invested in stocks. Along with increased potential for returns with a larger percentage of the portfolio invested in stocks, the income the investor receives by writing call options and investing them in more of the stock index may also provide the investor some protection against losses in exchange for limiting potential gains. Results indicate that shifting asset allocation appears to be the better strategy when compared with the put option insurance portfolios. Overall the call option insurance portfolios returns are superior to the asset allocation portfolios. On a risk adjusted basis, an argument can be made that the fixed percentage call option insurance portfolios outperform the asset allocation portfolios, when the asset allocation favors stocks. © 2013 Academy of Financial Services. All rights reserved.



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## Strategies for mitigating the risk of outliving retirement wealth

Vickie Bajtelsmit, LeAndra Ottem Foster, Anna Rappaport

Whether retirement wealth will last a lifetime depends on many factors, including spending and saving decisions, investment performance, qualification for defined benefit or other annuity income streams, health care costs, long-term care (LTC) risk, and longevity. Individuals may be able to improve retirement outcomes by making better-informed choices both before and during retirement. This article uses Monte Carlo simulation to simultaneously model stochastic financial, health, long term care, and life risks and evaluates which financial strategies best mitigate the risk of outliving retirement wealth. A combined strategy of delayed retirement and Social Security claiming, reduced discretionary spending, and LTC insurance is found to greatly improve retirement outcomes for typical retiree households. © 2013 Academy of Financial Services. All rights reserved.

## What homebuyers need to know about the differential risk of mortgages

Larry J. Prather, Che-Chun Lin, Ting-Heng Chu

Because homeownership represents the largest investment many individuals make, and the credit risks of competing mortgage products are not well understood, we develop a framework to quantify absolute and relative credit risks of mortgage products. We use simulations to examine the default rates of five types of mortgage products under both a normal and stressed economy to examine relative risk differences among the competing mortgage products. Results suggest that some mortgage products have a default risk four times larger than fixed-rate loans and default probabilities of 30% in a stressed economy. As a result, homebuyers should consider the credit risk of competing mortgage products before selecting a mortgage.

## A comparison of single factor and multiple factor alphas used in measuring mutual fund performance

Brian Betker, Joseph Sheehan

We compare mutual fund alphas computed using single factor models commonly used by practitioners with the alphas computed using the multifactor models common in academic research. Although all methods seek to control for a fund's investing style, single-factor alphas exceed multifactor alphas by 50–75 basis points per year on average, with the biggest differences concentrated in small cap funds. Although good performance does not tend to persist, single-factor alphas are about twice as likely to show persistence compared to three- and four-factor alphas. Investors should add multifactor alphas to the set of information used to evaluate mutual funds. © 2013 Academy of Financial Services. All rights reserved.

## Financial knowledge and student loan usage in college students

Victoria Javine

The purpose of this study is to examine the level of knowledge students have pertaining to student loans. College tuition has increased over time. Consequently, the number of students requiring financial aid in the form of student loans has increased. This study measures the level of knowledge students have about these loans to assess whether or not financial knowledge and other demographic information predicts the level of student loan debt. The results indicate that students in a later year in school and students with lower grade point averages are more likely to have higher student loan debt levels. Additionally, the results indicate that in-state students have a lower probability of having higher loan values. Race is also a predictor of student loan debt levels. African American students are more likely to have higher levels of student loan debt than other races. Higher levels of credit-card debt and financial independence are also related to higher levels of student loans.

## Life insurance consumption as a function of wealth change

Wookjae Heo, John E. Grable, Ph.D, Swarn Chatterjee

This article used a large nationally representative longitudinal dataset to explore the association between changing socioeconomic factors and household consumption of life insurance across time. This study specifically examined the association between changes in wealth and life insurance consumption controlling for household characteristics and psychosocial factors. Empirical results indicate that during the 2004–2008 period, an increase in net worth was positively associated with purchases of additional cash value life insurance at the household level. Women and Black households were also more likely to increase their life insurance consumption during this period. Saving intention was likewise found to be positively associated with an increase in household life insurance consumption. Results suggest that life insurance acts a complement to, rather than substitute for, wealth. Implications of the findings of this study for individual investors, scholars and practitioners have been included. © 2013 Academy of Financial Services. All rights reserved.