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Financial Advisors and Multiple Share Class Mutual Funds (pp. 1–20)

Michael A. Jones, Vance P. Lesseig, Thomas I. Smythe

The development of multiple share class mutual funds has complicated the investment decision for individual investors such that the advice of financial advisors is heavily relied upon to make the best choice. However, there have been accusations that advisors are influenced by factors other than the client's best interests. This study surveys financial advisors as to their compensation and recommendations with respect to multiple share class funds. Our results suggest that advisors may not be sufficiently informed regarding the relationship between share classes, investment size, and investment horizon. We also find that advisor compensation appears to influence the frequency of sales of various share classes. © 2005 Academy of Financial Services. All rights reserved.

The Decision between Debit and Credit: Finance Charges, Float, and Fear (pp. 21–36)

Amanda Swift King, John T. King

We develop a simple model of a consumer's choice between using credit and debit and show that consumers are always better off using credit than debit when both types of cards are available for a purchase. This result is tested and the persistence of debit cards in the marketplace is examined using data from the 1998 Survey of Consumer Finances. Empirical evidence is presented suggesting that the persistence of debit cards in the marketplace is because of (1) the fact that even households that use credit cards without borrowing do not view credit as a substitute for debit and (2) consumers' fear of credit. © 2005 Academy of Financial Services. All rights reserved.

Drop-Out from Individual Development Accounts: Prediction and Prevention (pp. 37–54)

Mark Schreiner, Michael Sherraden

Individual Development Accounts (IDAs) provide matches for savings by the poor used to build assets. But IDAs cannot help if participants drop out. What predicts drop-out? For IDAs in the American Dream Demonstration, drop-out is less likely if participants already own some assets. In contrast, income and welfare receipt are not linked with drop-out. Drop-out is strongly associated with aspects of IDA design such as match rates, time caps, and the use of automatic transfer. Because drop-out can be predicted, IDA programs can keep costs down while targeting preventative assistance to the most at-risk enrollees. © 2005 Academy of Financial Services. All rights reserved.

Analysis of Factors Relating to Success on the CFP® Certification Examination (pp. 55–72)

Richard Cutler, Ph.D., E. Vance Grange, Ph.D., C.P.A., C.F.P., Vickie L. Hampton, Ph.D., C.F.P. Adele Cutler, Ph.D., Thomas P. Langdon, J.D., L.L.M., C.F.A., C.F.P., Michael T. Ryan, PhD, CFP

We analyzed survey data from examinees of six administrations of the CFP® Certification Examination between November 1999 and November 2001. We observed increases in the proportions of examinees that work in insurance and as attorneys, and in the proportion of persons whose highest degree is a baccalaureate. We updated earlier work on factors associated with success on the examination. One new result is that exam preparation, in hours per week, is positively associated with performance on the examination. The five variables that are most predictive of performance on the examination are exam retake (yes, no), primary business activity, registered program, SAT score, and holding a CPA license. ©2005 Academy of Financial Services. All rights reserved.

Long-Range Confidence Interval Projections and Probability Estimates (pp. 73–84)

William J. Trainor, Jr.

Accurately estimating long-range confidence intervals and probability estimates associated with an investment portfolio is critical to the financial planning process. To address this, computationally intensive data limiting Monte Carlo techniques have become popular. The results of this study suggest that simple theoretical probabilistic return projections based only on an expected return and standard deviation estimate are just as accurate. Thus, using a simple spreadsheet, financial planners and investors can accurately assess a wide range of possible outcomes for a myriad of asset allocations, investment amounts, and time horizons without needing to resort to more sophisticated methods. © 2005 Academy of Financial Services. All rights reserved.

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An analysis of single-stock futures trading in the U.S. (pp. 85–95)

Travis Jones, Robert Brooks

This paper presents an overview of how single stock futures (SSF) have developed since their introduction in the United States. We present a number of reasons why individual investor interest in SSF may not have reached its potential. Individual investors should note SSF volumes are very low and implied interest rates indicate that SSF settlement prices often have little relation to their respective underlying stock's closing prices. We present evidence of a number of non-dividend paying companies with underlying stock prices that closed above the settlement prices of their respective SSF, contradicting the carry arbitrage model. © 2005 Academy of Financial Services. All rights reserved.

In search of information content: portfolio performance of The 100 Best Stocks to Own in America (pp. 97–109)

Randy I. Anderson, Anthony L. Loviscek

Now in its seventh edition, The 100 Best Stocks to Own in America is an enduring and lucid reference for the active individual investor. Through the sixth edition, it had reportedly sold over 300,000 copies, indicating that it might contain information content, or stocks that can beat a broad market index on a risk-adjusted basis. Does it? As a response, we compare the out-of-sample Sharpe ratios of 30 portfolios constructed from the first six editions of Walden's rankings to the Sharpe ratios of the S&P 500. We find some evidence of information content and suggest that the individual investor focus on the top five stocks. © 2005 Academy of Financial Services. All rights reserved.

Distributing excess cash: the role of specially designated dividends (pp. 111–131)

H. Kent Baker, Tarun K. Mukherjee, Gary E. Powell

Investors can receive cash distributions from corporations through share repurchases, regular cash dividends, and specially designated dividends (SDDs). Understanding why firms choose one method over another to distribute excess cash has important implications for investors. We find that the primary motive for repurchasing shares is to take advantage of perceived market under valuation of the firm's shares. Having strong earnings and cash flows provide an impetus for both regular dividends increases and SDDs, but investors should view any increase in yield resulting from SDDs as temporary. They should interpret SDDs as conveying positive information about current excess performance, not long-run performance. © 2005 Academy of Financial Services. All rights reserved.

Financial vulnerability of small business owners (pp. 133–147)

Michael S. Gutter, Tabassum Saleem

This study examines the financial vulnerability of small business owners using data from the 2001 Survey of Consumer Finances. Financial vulnerability is determined by the extent to which income and wealth are derived from the same source. The findings suggest that business owners face unique financial vulnerability because of their reliance on the business as both a source of income and wealth. Business owners may have insufficient diversification when relying on the business as an asset to fund retirement. Among business owners, farmers are the most vulnerable; their proportions of total income and total portfolio attributable to the business are higher than other business types. © 2005 Academy of Financial Services. All rights reserved.

Comparing mean variance tests with stochastic dominance tests when assessing international portfolio diversification benefits (pp. 149–168)

Thomas O. Meyer, Xiao-Ming Li, Lawrence C. Rose

Stochastic dominance is theoretically superior to mean-variance (MV) analysis because it considers the entire return distribution and is based on minimally restrictive assumptions regarding investor motives. This study uses stochastic dominance to examine whether adding internationally based assets to a wholly domestic portfolio generates diversification benefits for an investor. In contrast to previous MV findings, a New Zealand-only portfolio stochastically dominates four internationally diversified portfolios across all periods considered. Similarly, the least internationally diversified portfolio persistently dominates more diversified counterparts. Within-portfolio analysis shows that in the Asian Crisis period, the least risky or lowest return weighting schemes dominate those with greater risk and/or higher return characteristics. © 2005 Academy of Financial Services. All rights reserved.

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Betting on death and capital markets in retirement: A shortfall risk analysis of life annuities versus phased withdrawal plans (pp. 169-196)

Ivica Dus, Raimond Maurer, Olivia S. Mitchell

Retirees must draw down their accumulated assets in an orderly fashion, so as not to exhaust their funds too soon. We compared alternative phased withdrawal strategies to a life annuity benchmark using German data; one particular phased withdrawal rule seems attractive, as it offers relatively low expected shortfall risk, good expected payouts for the retiree during his life, and some bequest potential. Results are similar for the U.S. case. Delayed annuitization may also appeal, as it offers higher expected benefits with lower expected shortfalls. © 2005 Academy of Financial Services. All rights reserved.

Probabilistic investing: or how to win the Globe and Mail's Stock Picking Contest (50% of the time) (pp. 197-211)

Moshe A. Milevsky, Thomas S. Salisbury

For the past nine years the Globe and Mail (Canada's oldest national daily) newspaper has held an annual stock picking contest. In 2002, 2003, and then again in 2004, a finance professor won this contest. Motivated and inspired by the contest, this article shows that a rational player can increase the odds of winning an investment contest to a 50/50 chance by selecting a stock that (1) is highly volatile, and (2) negatively correlated with the other selections, or (3) exhibits a negative empirical beta. We conclude by arguing that picking stocks to win an investment game or contest is quite different from selecting securities for a personal investment portfolio. © 2005 Academy of Financial Services. All rights reserved.

A NAV a day keeps the inefficiency away? Fund trading strategies using daily values (pp. 213-230)

J. Christopher Hughen, Prem G. Mathew, Kent P. Ragan

Previous research documents the value of closed-end fund trading rules based on the size of the weekly discount. The growing number of closed-end funds that provide daily net asset value data provides an opportunity to test the profitability of short-term fund trading strategies. We find that short-term trading strategies that purchase fund shares after large negative discount changes are profitable, on average, even when transaction costs are incorporated. However, strategies that short sell fund shares after large positive discount changes do not produce an average profit. The limited amount of trading in closed-end funds may make it difficult to achieve short-term profits from discount fluctuations. © 2005 Academy of Financial Services. All rights reserved.

Easing college students' transition into the financial planning profession (pp. 231-251)

Joseph W. Goetz, Joseph W. Tombs, Vickie L. Hampton

Like law, accounting, and medicine, financial planning is an applied profession. A mastery of "book knowledge" is insufficient preparation for a student entering an applied profession. The traditional model of financial planning education is inefficient in that it leaves students with a long and expensive transition into professional practice. This article proposes a new model that shortens this transition and includes an overview of various teaching techniques designed to integrate the professional world with the financial planning curriculum. Contact information for select educational programs already working to ease the transition is provided for those desiring to model effective teaching techniques. © 2005 Academy of Financial Services. All rights reserved.

Expected returns, correlations, and optimal asset allocations (pp. 253-267)

Doug Waggle, Gisung Moon

With increasing uncertainties in financial markets, individual investors now face difficult asset allocation choices. This article provides a framework for this deliberation by examining the marginal effects of the key input variables in the asset allocation for a portfolio of stocks, bonds, and bills. Expected stock returns are positively related to the optimal weight on stocks, but we show that the magnitude of this relation depends upon both the expected stock-bond correlation and the investor's attitude toward risk. We also find that an increase in the expected stock-bond correlation leads to shifts from bonds to bills for more risk-averse investors. © 2005 Academy of Financial Services. All rights reserved.

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The efficacy of optimization modeling as a retirement strategy in the presence of estimation error (pp. 269–284)

Christine A. McClatchey, Shawn P. VandenHul

We examine the time series performance of mean variance efficient portfolios in the retirement setting. Using a rolling period optimization model we create portfolios with the same ex ante risk as several naı¨ve 1/n strategies to discern whether optimization can improve return performance. Data are simulated from TIAA-CREF retirement accounts during 1994 through 2004. We correct for estimation error using weight constraints and James-Stein adjustments. Overall results indicate optimization does outperform most naı¨ve investment strategies. The investor's terminal wealth improves 2–30%,depending on the underlying asset allocation and assumed time to retirement. Adjustments for estimation error do little to further enhance investment returns. © 2005 Academy of Financial Services. All rights reserved.

Household debt over the life cycle (pp. 285–304)

Tansel Yilmazer, Sharon A. DeVaney

Using data from the 2001 Survey of Consumer Finances, this study examines how the holding of types and amounts of household debt changes over the life cycle. The results show that the likelihood of holding each type of debt and the amount of each type of debt compared to total assets decrease with age. Although the popular press has speculated that older households accumulate excessive amounts of mortgage debt and credit card balances, our results do not support this claim. However, there is evidence that it may be more difficult for poorer older households to pay off their credit card balances. © 2005 Academy of Financial Services. All rights reserved.

Do equity-linked certificates of deposit have equity-like returns?

(pp. 305-318)

Michelle Edwards, Steve Swidler

In recent years, equity-linked certificates of deposit (ELCDs) have become widely available to investors as banks strive to remain competitive. Banks sell these instruments as having the safety of a traditional CD with potential market-like returns. However, valuing these instruments can be difficult because the terms vary and the returns depend upon future market conditions. This paper uses Monte Carlo simulation to examine their return distribution. While individuals might find the typical ELCD a more attractive instrument than a 5-year Treasury note, a synthetic ELCD consisting of a zero-coupon bond and stock index call option may be an even more appealing investment. © 2005 Academy of Financial Services. All rights reserved.

Within-horizon exposure to loss for dollar cost averaging and lump sum investing (pp. 319-330)

William J. Trainor Jr.

Based on a statistic known as “first-passage time probability” that accounts for exposure to loss during the entire investment horizon, it is shown that dollar cost averaging relative to lump sum investing can significantly reduce the probability, magnitude, and duration of enduring a large loss. This is especially relevant to investors with minimum loss thresholds, possible interim withdrawal needs, changing asset allocations, and/or an uncertain retirement date. For investing in stocks with a 5-year horizon, the probability of enduring a loss can be reduced from over 90% to less than 50%, the dollar amount of the conditional expected shortfall can be reduced by 65%, and the expected time one may have to endure a loss is reduced from 1.5 years to 4 months. © 2005 Academy of Financial Services. All rights reserved.

Influence of future time perspective, financial knowledge, and financial risk tolerance on retirement saving behaviors (pp. 331-344)

Joy M. Jacobs-Lawson, Douglas A. Hershey

The purpose of this study is to explore the extent to which individuals’ knowledge of retirement planning, future time perspective, and financial risk tolerance influence retirement saving practices. A total of 270 young working adults participated in the study. Regression analyses reveal that each of the three variables is predictive of saving practices, and they interact with one another as well. From an applied perspective, the findings suggest that counseling and intervention efforts aimed at promoting retirement saving should differentially target individuals on the basis of these three psychological dimensions. © 2005 Academy of Financial Services. All rights reserved.