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Determinants of Planned Retirement Age (pp. 1-15)

Catherine Phillips Montalto, Yoonkyung Yuh, Sherman Hanna

Determinants of planned retirement age are analyzed. The prediction equation indicates that planned retirement age increases substantially as people get older, and increases somewhat with higher non-investment income. Social Security reform should recognize that the capacity to continue working and the ability to afford to retire both influence the age at which people plan to retire. The range of planned retirement ages suggests that research on the adequacy of retirement preparation should focus on planned retirement age. Financial planners should consider the finding that planned retirement age increases with age.

The Impact of the Pension Fund on The Decision to Work One More Year (pp.17-31)

Walt Woerheide

The decision to retire or work one more year is quite complex. One factor that plays a role in this decision is the net salary derived from working one more year. The type of pension a person has, defined benefit or defined contribution, will influence whether the net salary is larger than, equal to, or less than the stated salary. The larger the net salary relative to the stated salary, the more likely an employee is to continue working. This paper defines the net salary percentage for each type of pension plan and looks at empirical estimates for these values.

Beliefs and Actions: Expectations and Savings Decisions by Older Americans (pp.33-45)

Harold W. Elder, Patricia M. Rudolph

To understand the interaction of savings behavior, pension fund participation and expectations of retirement well being, we ask two questions. Are expected pension benefits a substitute for accumulated savings in replacing pre-retirement income? Are individuals' expectations concerning their retirement standard of living realistic based on their accumulated savings and pension plan participation? First-wave data from the Health and Retirement Study (HRS) are analyzed using a probit regression. The results are consistent with the idea that pension benefits are substitutes for saving and that accumulated savings have a significant impact on the expected standard of living but pension plan participation does not.

The Asset Allocation Decision in Retirement: Lessons from Dollar-cost Averaging (pp.47-63)

Premal P. Vora, John D. McGinnis

How should a retiree allocate his wealth between stocks and bonds? We address this question by studying whether it would have been better to have consumed periodically from stocks than from bonds over the seven decades of U.S. financial markets beginning in 1926 and ending in 1995. We find that retirees would have consistently done better by investing in stocks as opposed to bonds. When we analyze dispersion in consumption around its mean we find that there are greater chances for low consumption from the bond portfolio and greater chances for high consumption from the stock portfolio. Thus, we challenge the conventional wisdom that one should move away from stocks and towards bonds as one ages.

Social Security Investment Accounts: Lessons from Participant-Directed 401(k) Data (pp.65-78)

Jack L. VanDerhei, Kelly A. Olsen

Newly available 401(k) participant investment data may have implications for individual Social Security account (IA) proposals. We found that women with wages between $25,000 and $50,000 have a significantly greater probability of investing a small percentage of their 401(k) in equities than their male counterparts, but those with salaries over $75,000 have a smaller probability. Hence, women’s less aggressive investment behavior may be primarily due to younger cohorts and may not apply above a threshold wage. However, overall, 28.4 percent of men and 33.8 percent of women are conservative investors, suggesting the possible risk low IA accumulations under some proposals.

Asset Allocation Decisions in Retirement Accounts: An All-or-Nothing Proposition? (pp. 79-92)

Doug Waggle, Basil Englis

An examination of survey responses about Individual Retirement Account (IRA) holdings reveals that individuals often take all-or-nothing approaches in their decisions to diversify across the asset categories of cash, bonds, and equity. Two thirds of survey respondents put their entire IRA holdings into a single asset category. A surprisingly large proportion of funds is held in cash, while only a minimal amount is invested in bonds. These findings also contrast with those of Bodie and Crane's (1997) examination of TIAA-CREF participants, which is heavily weighted with individuals holding fixed income annuities. Our results suggest that there is a compelling need for risk education for investors.

Social Security Reform: The Effect of Investing in Equities (pp.93-106)

Erick Elder, Larry Holland

Several proposals have been developed to reform the Social Security System to ensure that it is fully funded. The investment of a portion of Social Security funds in equities has often been proposed as a means to avoid increasing payroll taxes. This paper develops a general equilibrium model to demonstrate that investing Social Security funds in equities will decrease the return on equities and increase interest rates on bonds, which also leads to an increase in general income taxes. Thus, investing Social Security funds in equities simply shifts a potential increase in payroll taxes to an increase in income taxes.

An Analysis of the Medical Savings Account as an Alternative Retirement Savings Vehicle (pp.107-123)

J. Tim Query

Personal savings as a percentage of disposable income have dropped steadily since the early 1980s. Savings have continued to decline in 1999, as the savings rate – savings as a percentage of after-tax income – dropped to a record low of minus 0.7 percent in April 1999, according to the Department of Commerce. The study finds that MSA-type accounts are a viable supplement to retirement savings, buy should not be used as a replacement for existing retirement alternatives given their current structure. Results show that future health care expenditures are an important factor in the success or failure of MSAs as supplemental retirement accounts. Medical Savings Accounts are currently eligible for long-term care expenses, and to the extent that such expenses occur during retirement, MSA balances could be used to pay for retirement expenses. In that respect the accounts already capture the characteristics of a retirement savings account. A comparison of the Roth IRA with the MSA as defined by the 1996 HIPAA legislation is also conducted.

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Market Timing Using Strategists' and Analysts' Forecasts of S&P 500 Earnings Per Share (pp. 125-144)

Richard Chung, Lawrence Kryzanowski

This paper examines the bias in and usefulness of top-down and bottom-up consensus forecasts of earnings per share for the S&P 500 Index provided by market strategists and analysts to I/B/E/S. These forecasts exhibit a significant optimism bias that decreases over the 12 months up to release of actual earnings per share. The bias is significantly more pronounced for the bottom-up forecasts of analysts. Unlike the findings for country timing, we demonstrate that a stock market timer using switching rules based on the consensus forecasts of S&P 500 earnings or the directional switch in the consensus or in the number of switchers cannot generate a free lunch.

Stock Selection Based On Morningstar's Ten-Year, Five-Star General Equity Mutual Funds (pp. 145-157)

Anthony L. Loviscek, W. John Jordan

Recent research suggests that the individual investor can build stock portfolios that outperform broad market indices. Based on this research and on evidence supporting the persistence of mutual fund performance, we test whether or not the individual investor can build market-superior portfolios from stocks selected from the top holdings of Morningstar=s ten-year, five-star general equity mutual funds. We use modern portfolio theory to construct the portfolios. Although the portfolios tend to outperform the S&P 500 for the 1990's, we conclude that the evidence is not strong enough to recommend this stock selection strategy to the individual investor.

Risk Tolerance and Asset Allocation for Investors Nearing Retirement (pp. 159-170)

Govind Hariharan, Kenneth S. Chapman, Dale L. Domian

This paper uses a large individual-level data set to isolate the effects of risk tolerance on portfolio composition. We test and confirm two predictions of the Capital Asset Pricing Model: (1) increased risk tolerance reduces an individual's propensity to purchase risk-free assets; and (2) higher risk tolerance does not affect the composition of an individual's portfolio of risky assets. More specifically, we find that risk tolerant investors nearing retirement do not reduce their bond allocations in order to buy more stock.

The Information Content of Closed-End Country Fund Discounts (pp.171-181)

John E. Richard, James B. Wiggins

This paper examines whether premiums and discounts on closed-end country mutual funds (CECFs) contain useful information about future returns. We find that higher CECF premiums are associated both with higher future returns on the relevant foreign market index and with higher future NAV returns after controlling for the foreign market return. CECFs trading at large discounts are not necessarily bargains, because their future NAV performance can be expected to be relatively poor.

Liquidating A Remainder Interest: Simplifying Personal Finance (pp. 183-195)

Tony Cherin, John C. Bost

There are many ways in which decedents leave property in trust for their heirs. One technique is to grant a life estate to surviving children. The purpose of this paper is to describe verbally, and through example, an approach to liquidating a life estate. This simplification in personal finance involves a “buyout” of the interests of the remaindermen. The result is dissolution of the trust, leaving the income beneficiaries to manage, as owner in fee, the remaining assets as they wish, without the expense and complexity associated with maintaining a trust.

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Design Considerations For Large Public Sector Defined Contribution Plans (pp. 197-218)

Kevin W. SigRist Stewart L. Brown

The paper identifies differences between private (401 (k)) plans, which have evolved under ERISA and existing public plans, which have not. Examination of model legislation reveals that public plans should largely conform to ERISA going forward and reflect best practices in the private sector. Empirical analysis of equity mutual funds with $1.8 trillion in assets and institutional equity accounts with $98 billion in assets demonstrates efficiencies in separately procured institutional investment, administrative and educational services relative to retail investment products. The analysis points to tension between the duties of trustees and the demands of participants requesting large numbers of retail investment options.

Exploitable Patterns In Retirement Annuity Returns Evidence From TIAA/CREF (pp. 219-230)

Edward M. Miller, Larry J. Prather

Evidence suggests that predictabilities in asset class returns exist but transactions costs prevent exploiting them using individual securities. Extant research also shows that these relationships may by exploitable through the trading of mutual funds but fails to examine whether this relationship exists within an individual fund family. This paper finds that TIAA/CREF retirement annuities exhibit predictable elements that could be exploited by informed traders. The proposed trading strategy dominates a buy-and-hold strategy by producing higher raw and risk-adjusted returns. Additionally, the risk is greatly reduced.

Retirement Planning Guidelines: A Delphi Study Of Financial Planners And Educators (pp. 231-245)

Sue Alexander Greninger, Karrol A. Kitt, Vickie L. Hampton, Susan Jacquet

Retirement planning guidelines were determined using a Delphi research design among 188 financial planners and educators. Consensus was found for using a 4% inflation rate, an 8.5% rate of return on investments, and a replacement ratio of 70-89% of current income when making retirement projections. Nine-tenths of the experts agreed that families should have achieved 50-60% of their retirement savings goal by age 50 and 85-90% by age 60. Regarding asset allocation, over 60% felt it was prudent to start moving toward more conservative investments about 3-5 years before retirement. Recommendations were developed on the proportion of growth-oriented equities to hold at various points prior to and after retiring. While the level of consensus was high, occupational and gender differences were noted.

Performance Persistence and Management Skill In Non-Conventional Bond Mutual Funds (pp. 247-258)

James Philpot, Douglas Hearth, James Rimbey

Recent empirical research has identified a tendency for equity mutual funds to provide consistent performance relative to other funds over time. Studies of bond funds have centered around investment grade, straight bonds and have concluded that fund managers outperform indexes on a gross (although not net) basis, but that performance is hampered by high expense levels. We examine non-conventional bond funds (high-yield bonds, global issues and convertible bonds) and find that short-term performance persistence is present, but limited to the high-yield bond sub-sample. Fund managers are unable to distinguish themselves in the long term, despite the diverse nature of the funds they oversee.

The Effect Of Countryside Index Trading On Closed-End Country Funds: An Empirical Analysis (pp. 259-275)

Matthew O’Connor, Ph.D., Edward A. Downe, Ph.D.

The American Stock Exchange initiated trading in 17 World Equity Benchmark Shares (acronym“WEBS”TM) in April 1996. WEBS are index funds designed to track the Morgan Stanley Capital International (MSCI) indexes. We examine the effect of this event on closed-end country funds (CECFs) and find that percentage discounts increase. CECFs with a corresponding WEBS index experience the largest increase and also show a decline in trading volume. We attribute these results to (1) the effects of increased competition and (2) a reduction in the market segmentation premium. Since additional WEBS have begun trading, and other approvals may follow, similar effects could be experienced in the future.

Consumer Information Search For Home Mortgages: Who, What, How Much, And What Else? (pp. 277-293)

Jinkook Lee, Jeanne M. Hogarth

The remainder of the paper is structured as follows. First, we present background information related to mortgage markets, followed by a review of previous studies on mortgage shopping behavior. Then, using data from the 1997 University of Michigan's Survey of Consumers, we identify consumers' information search patterns when shopping for a mortgage loan. Specifically, we examine the interdependence of information search activities, providing further insights on consumer search behavior. Finally, we provide a discussion for the research and consumer outreach communities.

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Strategic Asset Allocation for Individual Investors: The Impact of the Present Value of Social Security Benefits (pp. 295-326)

Steven P. Fraser, William W. Jennings, David R. King

This paper demonstrates the dramatic effect of social security wealth on individuals' asset allocation. We first discuss why social security wealth should be included in portfolio asset-mix decisions. We then draw parallels between social security benefits and inflation-indexed treasury bonds to help quantify the present value of social security benefits. Finally, we show the portfolio impact of including social security wealth under several asset-mix decision rules. Excluding social security wealth from the asset mix decision results in sub-optimal portfolios. Including social security wealth provides an incentive for including more stock in the asset mix.

The Equity Index Annuity: An Examination of Performance and Regulatory Concerns (pp. 327-342)

Gregory A. Kuhlemeyer

The Equity Index Annuity (EIA) is a recent product development in the insurance industry. This paper details EIA design and interest crediting techniques, examines expected performance, and discusses possible regulatory concerns. Results indicate that the EIA is generally expected to perform better than a traditional fixed annuity for contract periods of at least five years, but is substantially below that of a similar direct equity purchase. EIA contracts are not appropriate for shorter-term investors when factors of risk and efficient markets are considered. The SEC is not currently regulating the EIA product, which should raise industry concern.

Financial Services and the African-American Market: What Every Financial Planner Should Know (pp. 343-359)

D. Anthony Plath, Thomas H. Stevenson

African-American consumers differ markedly from their Caucasian counterparts in terms of financial product preferences, product research, and investment asset portfolio composition. This study examines some of the principal differences between African-American and Caucasian households in evaluating and purchasing investment assets and explores differences in asset holdings between the two racial groups. This information can help financial planners seeking to market to the African-American community better understand this community, tailor investment information for the unique needs of this community, and render more effective service to individuals and families that comprise this attractive and growing market segment.

The Reliability of the Book-To-Market Ratio As A Risk Proxy (pp.361-373)

Ralph R. Trecartin Jr.

This study examines whether the book-to-market ratio consistently explains the cross-section of stock returns through time. The results reveal that the book-to-market ratio is positively and significantly related to return in only 43% of the monthly regressions. Other value/growth variables such as "Cash Flow", "Sales Growth," and "Size"; perform even more erratically than the book-to-market ratio, and are thus less likely to be viewed as legitimate risk proxies.

On Time: Contributions from the Social Sciences (pp. 375-387)

Barbara S. Poole

This paper provides a brief review of the anthropology and psychology literature as it relates to time, an important variable in finance. First, the paper discusses ways that individuals represent time, and introduces cultural variations in the perception of time. Then the experience of time passing, and behavioral pace, is discussed. The succession of time and the orientation toward past, present, and future, are described. The paper may provide implications for academics whose finance research is related to behavior over time.

Hedonic Investment (pp. 389-403)

Douglas E. Allen, Elton G. McGoun

Investing and consuming may not be so different as traditional economic theory has understood them. The consumer research literature has begun to view consumption not simply as rational decision making, but as a more multi-sensory activity in which emotion and fantasy play important, if not essential, roles. This new perspective has been extended by Holt (1995) in a matrix of metaphors in which consumption can be viewed as an interaction with objects and/or other persons as an end in itself and/or a means toward toward other ends. This paper theorizes how this matrix might apply to investment and uses a literary analysis of the best-selling The Motley Fool Investment Guide to examine whether or not our knowledge of consumers might in this way inform our understanding of investors.