Financial Advice, Investment Knowledge, and Portfolio Diversification

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Abstract

Household portfolio diversification is a very important factor in accumulating wealth. In fact, incorrect investment decisions during the accumulation process, especially under-diversification of assets, can be extremely costly. One of the benefits of receiving financial advice from a professional is diversification of assets, however, financial advice can also be obtained from other sources such as family/friends and an investor's own judgement. This study examines the relationship between investor's subjective and objective investment knowledge and explores how information sources used when making an investment decision affect non-retirement account diversification. Using data from the 2015 Investor Survey (FINRA) and an ordered probit model, the results reveal that investor's subjective investment knowledge has a positive and significant relationship with the probability of having the most diversified portfolio than the investor's objective investment knowledge. In addition, the results show a positive relationship between using financial advisor as an information source when making an investment decision and the probability of having the most diversified portfolio compared to using family/friends or own judgment.

Key words: asset diversification, subjective and objective investment knowledge, investment information source

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