

Overconfidence and its effect on investment performance: How Men and Women Differ in their Approach to Investing

Economists Brad Barber and Terrance Odean published research in 2001, looking at 35,000 households and their investment behavior. What they found was that men traded 50% more than women, lowering their investment results and raising their costs. Now this year Vanguard has studied 2.7 million people holding IRAs there. The finding was that men were much more likely than women to sell their investments at the stock market lows in 2008, thereby locking in large losses and missing the start of the 2009 market rally.

What Vanguard concluded was that, generally speaking, men appear to be overconfident, i.e. that they “think they know what they’re doing, even when they really don’t know what they’re doing.” On the other hand, women, as a group, appear much more likely to leave their investment strategy in place, feeling that they don’t have a way of figuring out what direction the market will go. So that means that women tend to “stay the course” better than men, sticking with their investment strategy and perhaps rebalancing their portfolios periodically. Any of you who have been with me for a few years probably recognize these tendencies as characteristics of good, long-term investors who eschew market timing.

As Professor Barber puts it: “In general, overconfident investors are going to be interpreting what’s going on around them and feeling they are able to make decisions that they’re really not equipped to make.” Thinking in such a way often leads investors to believe that they can or should time the market, i.e. make investment decisions based on current events or market conditions, when, in fact, just the opposite is true; buying and holding is usually the best long-term strategy. Barber

goes on to point out that short-term financial news often amounts to little more than meaningless “noise.”

Before going further, I should point out that it is not my goal here to pick on male investors and certainly not my male clients, who, of course, all have excellent investment instincts. Rather, the lesson from these two studies of men vs. women investors is, in my view, that, for either gender, trading too frequently and divining trading tactics from what’s going on in the world are both very detrimental to investment results. I’m certain also that there are plenty of female investors who try to time the markets.

A final observation of the Vanguard study was that women are, generally speaking, more risk averse than men. This could conceivably hold back their investment returns, but in the last 10 years it certainly would have had beneficial results. Excessive risk-taking has gotten some investors into quite a hole in the 2000-2002 market downturn and also in the 2008 global financial crisis. And as you may know, for the past several years, I’ve been advocating that most of you adopt a more conservative investment strategy. You might recall me pointing out that if you lose 50%, you need to gain 100% to get back to breakeven, whereas if you lose just 25%, what’s needed to get back to where you were is only a 33% gain.

As I’ve always said, the future is totally unknowable, so it’s best to arrive at a comfortable mix of stocks, bonds, cash and alternate investments and then stick with those investments in good times and bad, periodically skimming profits and once or twice per year rebalancing the portfolio.