FUNDED BY THE FINRA INVESTOR EDUCATION FOUNDATION GRANT PROGRAMS

# Examining the Investor Confidence of Minorities in America

This fact sheet provides a cultural perspective about the investment behavior of racial/ethnic minorities in America. The topics discussed here include minorities' risk tolerance levels and confidence in their own investment abilities. The facts discussed here suggest that financial education programs for minority adults would be best suited if they were tailored to the needs of each specific audience.

The study "Gender Differences in Investment Behavior" (Hira and Loibl, 2006) identified a number of significant environmental and personal factors that influence investment behavior in America. This study paid particular attention to the investment actions, attitudes, motivations, needs, and wants of women in high-income households (for more information about women investors, see "Examining the Investment Behavior of High-Income Women in America," "Comparing Search Strategies for Investment Information in America," "Strengthening Investor Confidence of High-Income Women in America," and "Promoting Investment Involvement among High-Income Women in America"). The study also revealed useful knowledge about the investment behavior of minorities in America. It began to answer questions about racial/ethnic minorities' risk tolerance levels and confidence in their investment abilities. This fact sheet summarizes those findings and discusses their implications for financial educators.

*Tahira K. Hira, Professor, Iowa State University*
*Cäzilia Loibl, Assistant Professor, The Ohio State University*
*Tom Schenk, Jr., Graduate Student, Iowa State University*

## Methods

In the fall and winter of 2005 and 2006, the Iowa State University Center for Survey Statistics and Methodology conducted a telephone survey of a representative sample of high-income investors in the United States. In all, 911 telephone interviews were completed, producing a twenty-two percent response rate. Each phone interview lasted an average of twenty-two minutes.

About twenty-three percent of the interviews were conducted with members of three minority groups, with roughly equal numbers of African American (7.46%), Asian (7.57%), and Hispanic (7.57%) respondents. Fifteen respondents refused to specify their race or reported a mixture of minority backgrounds. Data analysis of their responses revealed knowledge about high-income minorities' investment behavior in America, beginning with their responses about risk tolerance. For more information regarding the methods and design of this study, see the fact sheet titled "Studying the Investment Behavior of Women & Men in America."

## Risk tolerance level

Risk tolerance is the acceptable amount of risk an individual investor is willing to undertake. While risk tolerance is only an individual preference, large deviations of risk preference between social groups of people (e.g., race, education) can lead to different portfolio returns and wealth inequalities. High-risk investors are more likely to invest in annuities, corporate bonds, and stocks than CDs, money market accounts, and cash (e.g., savings accounts and money market funds).

In this study, African Americans, Asians, and whites all report an equivalent proportion of high-risk thresholds, whereas a much smaller proportion of Hispanics (thirty percent) are willing to take high financial risks. But where Hispanics are less likely to hold high-risk assets, they are more willing to take average risks compared to the other racial groups. Also notable are the few whites who would only accept low risk. Only 8.5 percent of whites claim to accept, at most, low risk. Over twice the proportion of African Americans, Asians, and Hispanics are only willing to take low risks. However, the results did not reveal any discernable differences in overall risk tolerance level and asset ownership among the four high-income and high net worth racial/ethnic groups.

While not always the case, one's risk tolerance level may be closely related to one's investor confidence.

## Investor confidence

A pair of investors who have the same education may have different decisions and different investment outcomes. The cause of these differences comes from confidence in their own investment abilities, which are not directly attributable to financial knowledge. There is some empirical evidence that some investors, depending on socio-demographics, may be less confident than other investors. Only a couple of studies have begun to look at investor confidence, and these have primarily dealt with gender differences. This section will analyze racial/ethnic differences in investor confidence. To analyze these differences, we used three indicators of investment confidence: confidence in investment ability, level of concern about investment outcomes, and confidence in investment knowledge.

### *Investment abilities and outcomes*

In this study, Asians appear to be most confident in their ability to invest, followed by Hispanics. However, while Asians were the most confident in investment abilities, they were also more worried about the investment outcomes than any other group. Over sixty percent of the Asian respondents agreed or strongly agreed that they were worried about their investment abilities. Unlike Asians, Hispanics were confident about investments, but were not as worried about investment outcomes. Half of the Hispanics who responded reported they were not worried. The proportion of confident investors was lowest among African Americans and whites.

### *Investment knowledge*

More Asians than any other group also indicated that they were confident in their investment knowledge. The differences in the proportions of those who indicated confidence in investment knowledge among the various ethnic/racial groups of investors were not significant, but there does seem to be a relationship between respondents' confidence in their investment knowledge and confidence in their ability to invest.

Another area that aids in determining investor confidence is that of investors' confidence in their ability to invest for the future (retirement), discussed below.

## Retirement confidence

In this study, minority investors' retirement confidence was measured by three factors: their level of retirement contributions, their having clear ideas about the financial needs of retirement, and their confidence in having adequate finances during retirement.

Results show that a majority of the respondents in each group had IRA and Keogh accounts and were making maximum contributions to their employer-provided retirement accounts. However, Asians were more likely to maximize retirement contributions than investors in the other three groups (African Americans, Hispanics, and whites).

Over half of the respondents in each of the four groups felt that they were well-prepared for their retirement; they were confident that they would have adequate financial resources during the retirement period. However, when compared to other ethnic and racial groups, whites were less likely to express high confidence in their preparation for retirement.

The study's results do not reject the notion that minorities have different confidence levels, but they do suggest that racial and ethnic differences are not significant among high-income and high net worth households.

## Discussion and implications

The study's analysis of risk tolerance shows that high net worth racial/ethnic minorities are less likely to be risk tolerant and are less likely to hold high risk assets. It appears that minorities are *not* less likely to hold low risk assets once risk tolerance is controlled for. This implies that minorities' propensity to be relatively cautious investors stems from lower risk tolerance compared to whites. Even though risk tolerance is a difference in preference, it could have unfortunate long-term consequences. Holding lower yielding assets could result, if not already, a wealth gap to form due to systematic differences in portfolio returns.

The study also looked at racial differences in investor confidence. It found that Asian men were considerably more confident and were more likely to claim to be confident than other racial/ethnic groups. We are cautiously optimistic about the findings here. On the one hand, it is good that minority investors, particularly Asians, can feel confident and knowledgeable about investing. However, it is possible minority investors may become overconfident and over-trade, causing lower returns.

Lastly, the study analyzed the racial differences in retirement confidence. In our sample of high net worth investors, a majority of the respondents were confident about retirement confidence issues. Nevertheless, we found some stark differences between racial and ethnic groups. Namely, Asians were more likely to maximize their retirement contributions; however, Asians were least likely to claim to have a clear idea of their financial needs during retirement. Meanwhile, African Americans were least likely to claim they maximize contributions to their retirement accounts, but were simultaneously most likely to claim they have a clear idea of their financial needs and were the most confident in their upcoming retirement years.

For more on the cultural factors that contribute to differences in high-income minorities' investment behavior in America, see "Exploring the Financial Socialization of Minorities in America." But racial and ethnic differences are not the only differences that factor into investors' confidence in their abilities to invest, or in the risks they will take. Gender also plays a part in determining investment confidence and risk tolerance levels. For more on the differences gender can make in investment behavior, see the other fact sheets in this series: "Examining the Investment Behavior of High-Income Women in America," "Comparing Search Strategies for Investment Information in America," "Strengthening Investor

Confidence of High-Income Women in America," and "Promoting Investment Involvement among High-Income Women in America."

## References

Hira, T. and Loibl, C. (2006). Gender differences in investment behavior. <http://www.finrafoundation.org/Iowa%20State%20Milestone%203A%20Report.pdf>.