Piecing Together Shareholder Perceptions of Investment Risk

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Piecing Together Shareholder Perceptions of Investment Risk

Research Department
Investment Company Institute
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Introduction

Risk is one of the key elements of investing, and financial professionals strive to communicate its meaning—particularly the risk-reward characteristics of different investments—in words and concepts the average person can understand. Nevertheless, risk is one of the more misunderstood principles of investing. Findings based on a series of focus groups, commissioned as a part of this study, reveal that most investors look at financial risk as the potential to lose principal.

Broadly defined, risk is the chance of loss. However, financial risk is multifaceted. Investments can have currency, interest rate, inflation, credit, liquidity, or prepayment risks, among others. Complicating the analysis of financial risk is the fact that each investor has his or her own tolerance of and attitude toward risk, so that an investment considered "high risk" by one investor may be considered "low risk" by another. For example, an investor with a low risk tolerance may be kept awake at night by concerns about stock market investments while another investor with a high risk tolerance may consider stock market investments relatively low risk. Nevertheless, while risk-averse investors may be drawn to investments such as U.S. Treasury bonds, which have virtually no credit risk, they are accepting, knowingly or unknowingly, other risks such as liquidity risk, interest rate risk, and inflation risk.

Piecing Together Shareholder Perceptions of Investment Risk is an empirical study that seeks to discern shareholders' attitudes and perceptions about risk. This report concentrates on investors' perception of risk rather than the investment community's definition of risk. The study constructs a profile of shareholders according to their tolerance for risk and seeks to answer the following:

- What are mutual fund shareholders' attitudes about financial risk?
- How do shareholders who are high risk-tolerant differ from those who are low or moderately risk-tolerant?
- Is there a strong relationship between shareholders' risk tolerance and the types of financial products they own?
- Do some words suggest more risk to shareholders than other words?
- Do mutual fund shareholders and nonshareholders have different attitudes toward risk?

This study is a product of the Investment Company Institute's research staff and its Research Committee members. The Response Analysis Corporation (RAC) was engaged to work with ICI on this project.

Research Objectives and Methodology

The research objectives of this study are to examine mutual fund shareholders' perceptions of risk, identify selected words and phrases associated with risk, and determine the level of perceived risk mutual fund owners associate with various financial products. Finally, the study seeks to characterize shareholders according to their perceptions of and tolerance for financial risk.

RAC conducted in-home interviews with a random sample of 311 mutual fund-owning households and with 293 nonfund-owning households. The interviews were held with the household's primary or codecisionmaker for savings and investments.

The use of sample surveys is standard practice for deriving estimates about a total population. Estimates derived through survey sampling are subject to sampling error. The findings in this report represent the total population of mutual fund shareholders within an overall sampling error of plus or minus 7 percent at the 95 percent confidence level. The sampling error for the findings on nonshareholders is also plus or minus 7 percent. Appendix A includes a table showing the standard levels of error that should be applied to the detailed survey data in this report.

To construct a questionnaire that reflected investors' perception and definition of risk, ICI and RAC held focus groups with mutual fund owners and nonowners. The discussions revealed that investors recognize risk as an element of any investment, but that they perceive risk narrowly. Most focus group participants defined investment risk as the chance of losing the principal of their original investment. After some probing, a few individuals mentioned some of the other elements that make up risk and vocalized the idea that greater risk can lead to greater return. Overall, however, the concepts of investment risk were not well-articulated.

The reader should note that this research was not designed to provide demographic and financial characteristics of the general population of mutual fund shareholders. For a profile of the typical mutual fund shareholder and key shareholder segments, see ICI's *Profiles of Mutual Fund Shareholders*.

Because of rounding to the whole integer, some totals in figures throughout the report may not exactly equal 100 percent.

Organization of the Report

This report is divided into five chapters. The first three provide a detailed analysis of the risk assessment, investment orientation, and investment profile of low, moderate, and high risk-tolerant shareholders. Chapter 4 presents the results of the segmentation analysis of shareholder attitudes toward risk. Chapter 5 compares shareholders' risk assessment with nonshareholders' risk assessment. Methodological details and detailed tabulations are provided in the appendices.

Executive Summary

Piecing Together Shareholder Perceptions of Investment Risk is an empirical study that seeks to discern shareholders' attitudes and perceptions about investment risk. It concentrates on investors' perception of risk rather than the investment community's definition of risk. In addition to characterizing shareholders according to their perceptions of and tolerance for financial risk, the study identifies several other factors that will help financial advisers assess an individual's risk tolerance. The findings will also assist mutual fund complexes in communicating risk to investors and in better understanding their investors' investment expectations. The following summary highlights the key research findings.

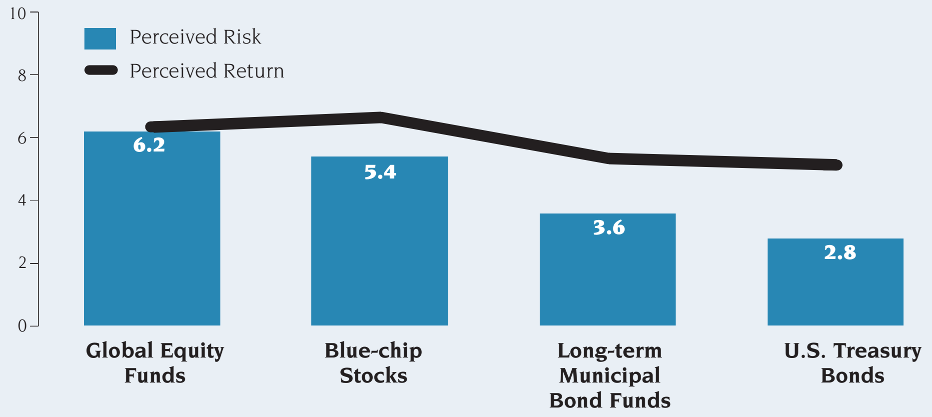
1. Financial risk is multisided. Investments can have currency, interest rate, inflation, credit, liquidity, or prepayment risks, among others. However, ICI research shows that most investors perceive risk narrowly. Both fund-owning and nonfund-owning focus group participants typically defined investment risk as the potential to lose principal—a one-dimensional view. Clearly, the multidimensional aspect of risk is one of the least understood principles of investing despite financial professionals' efforts to communicate its meaning to investors.

2. In examining investors' perception of the risk-return tradeoff, the ICI findings suggest that mutual fund shareholders have a better understanding of an investment's potential risk than its potential return, particularly the potential return of fixed-income products. Figure 1 shows that shareholders have a fairly accurate understanding of the potential risk associated with four investments that represent different points on the risk-return spectrum—global equity funds, blue-chip stocks, long-term municipal bond funds, and U.S. Treasury bonds. However, they perceive blue-chip stocks as having a greater potential return than global equity funds, and view long-term

FIGURE 1

Shareholders' Perception of Risk and Return for Four Investments

(mean score)*

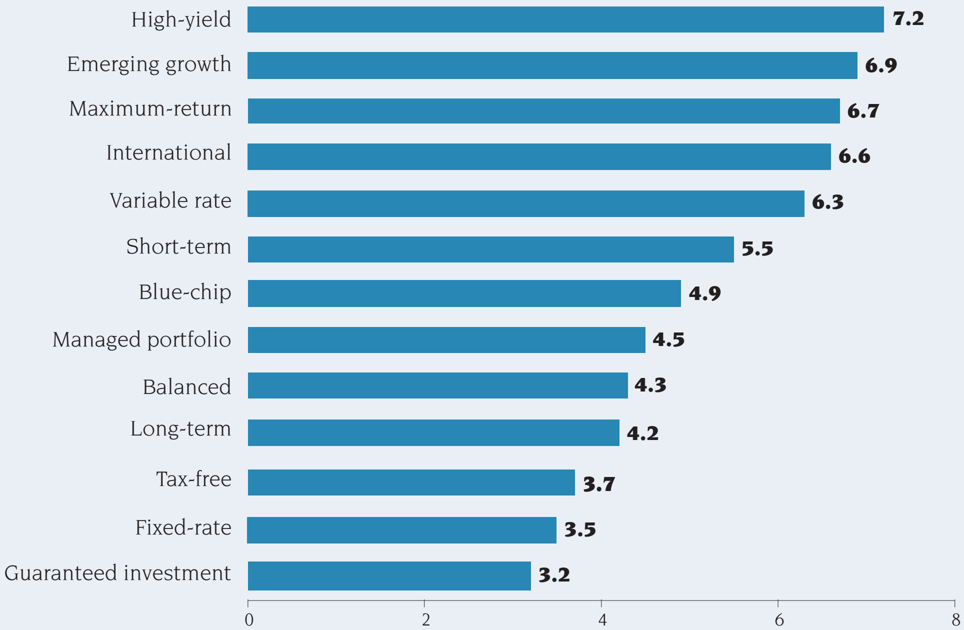


**Mean score, with ten equaling very risky or very high return and zero equaling not very risky or very low return*

FIGURE 2

Shareholders' Percentage of Risk for Selected Investment Terms

(mean score)*

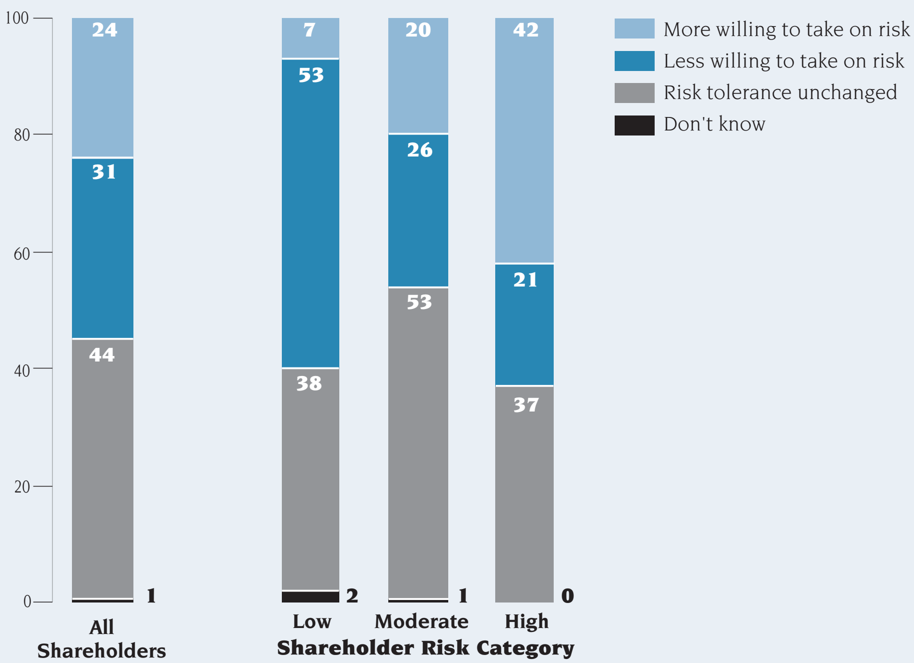


**Mean score, with ten equaling great deal of risk and zero equaling no risk*

FIGURE 3

Shareholders' Change in Risk Tolerance Since Time of First Investment*

(percent of respondents)



**See Appendix A for an explanation of the construction of the shareholder risk categories.*

municipal bond funds as having a potential rate of return similar to U.S. Treasury bonds. Moreover, the rate of return they associate with the two fixed-income products is high relative to the return they associate with the two equity products. (See page 11.)

3. Some investment terms connote more risk to shareholders than other terms. Figure 2 shows that, on a scale of zero to ten, with a score of ten equaling a great deal of risk, with a mean score of 7.2, "high-yield" evokes the image of most risk to shareholders. "Emerging growth" follows at 6.9. "Maximum return," "international," and "variable rate" each received a mean score between 6.0 and 7.0. At the other end of the scale, "guaranteed investment," "fixed-rate," and "tax-free" suggest very little risk to shareholders. Financial communicators may wish to pursue further shareholders' perception of investment terminology. (See page 11.)

4. A shareholder's family history can influence his or her investment behavior and tolerance for financial risk. More high risk-tolerant shareholders grew up in households that were interested in investing, discussed it, and owned investments than did low and moderate risk-tolerant shareholders. When compared with other shareholders, high risk-tolerant shareholders also made their first investment at a slightly earlier age and were more apt to invest in corporate stock, a financial product compatible with their acceptance of risk. (See page 17.)

5. Risk tolerance can change, which is good news for investor education programs. More than half of all shareholders indicate that their tolerance for risk has changed from the time of their first investment, a finding that reinforces the idea that an investor's position on the risk-reward spectrum is often dynamic, not static. Depicted in Figure 3, nearly a third of respondents say they have become more risk tolerant since they first started investing, while nearly one quarter say they have become less risk tolerant. (See page 9). As Figure 4 shows, changes in shareholders' risk tolerance also appear to be linked to demographic and economic factors such as changes in assets available for investing. (See page 23.)

6. In many instances, the content of a shareholder's portfolio reflects his or her tolerance for financial risk, and in other instances shows contradiction. These findings indicate that many investors could benefit from professional guidance in building a portfolio that meets their investment needs. Because shareholders understand that a diversified portfolio reduces financial risk and currently own several types of investments, they should be open to restructuring their portfolios to better match their tolerance for risk. Illustrating that shareholders often own investments that reflect their acceptance of risk, high risk-tolerant shareholders are the group most likely to own stock funds and individual stocks. Sixty-six percent of high risk-tolerant shareholders own stock mutual funds compared with just under half of low risk-tolerant shareholders. Illustrating that shareholders often own investments that contradict with their overall acceptance of risk, 60 percent of low risk-tolerant shareholders own individual stock and nearly half own stock funds. Likewise, 40 percent of high risk-tolerant shareholders own U.S. savings bonds, which carry virtually no credit risk, compared with 35 percent for low risk-tolerant shareholders. (See page 24.)

7. Shareholders who purchased their first mutual fund in the 1990s currently are more likely to be high risk-tolerant than low risk-tolerant. In fact, 51 percent of shareholders who bought their first fund in 1990 or later were classified as high risk-tolerant by the research. In contrast, shareholders who purchased their first fund before 1980 currently are likely to be either low or moderately risk-tolerant (Figure 5). Of course, much of the difference in risk tolerance between newer and more seasoned shareholders can be attributed to their age and changing investment goals. Other ICI research shows that the median age of shareholders who bought their first mutual fund in the 1990s is 37 years.

8. A shareholder's risk tolerance and investment behavior are linked. When compared with low risk-tolerant shareholders, high risk-tolerant shareholders tend to be confident, self-reliant, and very involved in their personal finances. The findings indicate that the more tolerant shareholders are of

FIGURE 4

Shareholders' Key Demographic Characteristics by Risk Category*

	Shareholder Risk Category		
	Low	**Moderate**	**High**
Median age	60	51	42
Median household income	$51,400	$61,200	$66,100
Percent of respondents			
Male	39%	46%	58%
Married	69	77	85
Widowed	17	8	2
Employed full- or part-time	50	68	80
Retired from lifetime occupation	53	31	15
Four-year college degree or more	39	57	66
Graduate degree	22	24	25

**Respondents were either the household's primary or cofinancial decisionmaker*

FIGURE 5

Shareholders' Risk Tolerance by Year of First Mutual Fund Investment

(percent of respondents)

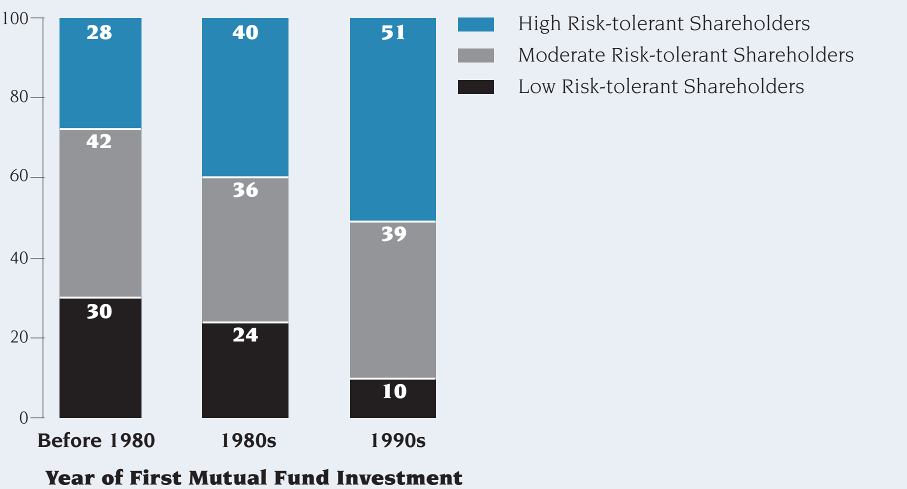
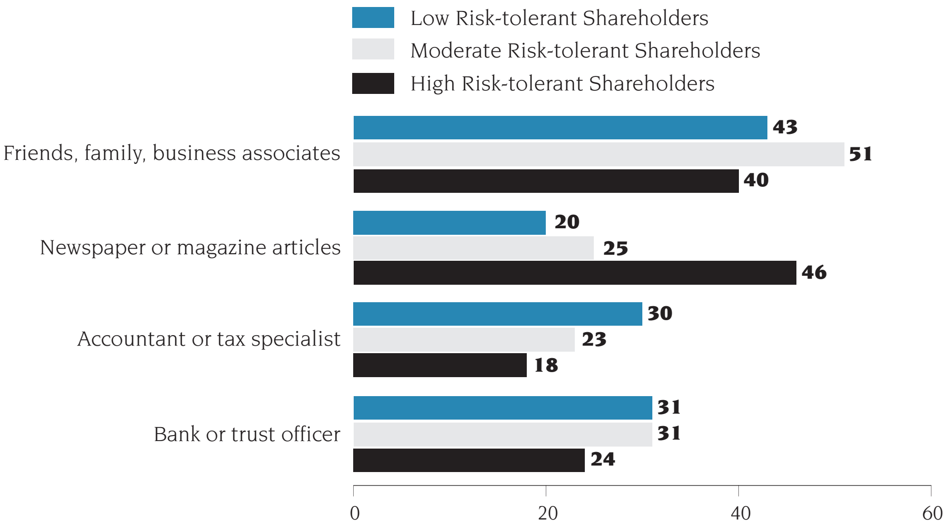


FIGURE 6

Shareholders' Use of Selected Sources for Financial information*

(percent of respondents)

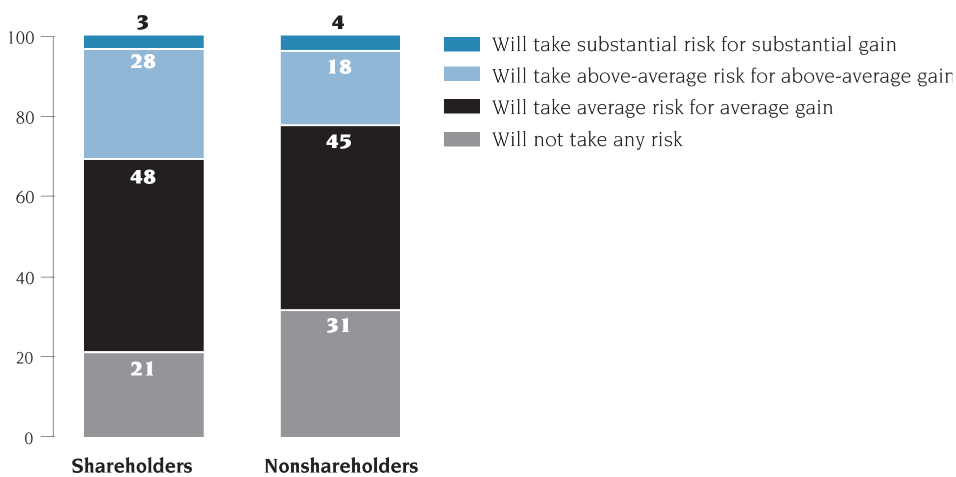


**Multiple responses included*

FIGURE 7

Comparison of Shareholders' and Nonshareholdres' Willingness to Take Financial Risk

(percent of respondents)



financial risk, the more closely they follow their finances, the more they enjoy managing their investments, the more likely they are to make their own investment decisions than depend on an adviser, and the more emphasis they place on long-term investment growth. The less tolerant shareholders are of risk, the more confused they tend to be by the investment options available to them, the more likely they are to turn to a broker or financial planner for assistance, and the more emphasis they place on preserving their investment principal. (See page 18.)

9. The sources shareholders contact for investment information vary depending on their risk tolerance. Figure 6 shows that, high risk-tolerant shareholders, who tend to be self-reliant, are the group most likely to read a magazine or newspaper article for investment information. In fact, 46 percent of high-risk tolerant shareholders say they have obtained investment information from a magazine or newspaper article. This compares with 20 percent for low risk-tolerant shareholders. Low risk-tolerant shareholders most often turn to friends, family, and business associates for investment advice and guidance. They also rely more heavily on accountants and bank officers than do their high risk-tolerant counterparts. (See page 25.)

10. In order to put mutual fund shareholders' tolerance for financial risk into perspective, their responses to several questions were compared with nonshareholders' responses. This comparison reveals that the two groups have very different attitudes about investment risk, and that mutual fund shareholders are generally more willing to take financial risk than nonshareholders. (Figure 7). However, fund owners and nonowners generally have the same perceptions about the words frequently used to describe financial concepts, a finding that indicates that written communications designed for shareholders also may be appropriate for nonshareholders. (See page 49.)

11. All financial professionals recognize the importance of assessing an investor's risk profile. The ICI research indicates that identifying the following factors with an investor can help determine their investment risk tolerance:

- The investor's perception of his or her own tolerance of financial risk,
- The investor's exposure to investing while growing up,
- The investor's demographic characteristics, particularly age, income, and education, and
- The investor's investment experience and knowledge.

Because an investor's risk tolerance can change over time, financial advisers should periodically reassess their clients' tolerance and adjust their portfolios accordingly.

Chapter 1

Risk Assessment

Have I not walked without an upward look
Of caution under stars that very well
Might not have missed me when they shot and fell?
It was a risk I had to take—and took

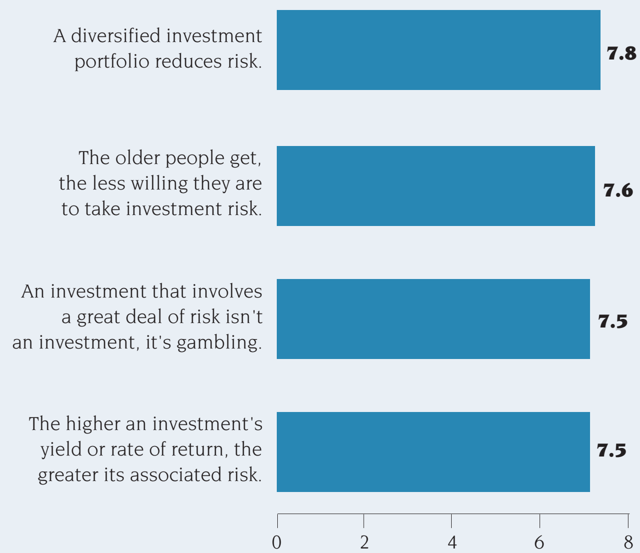
Robert Frost

Chapter 1. Risk Assessment

Chapter Summary

Nearly half of all shareholders describe themselves as willing to take average financial risk for average financial gain. The majority say their willingness to take investment risk has changed over time, with 31 percent saying they have become less willing and 24 percent saying they have become more willing. Most shareholders do not think the risk associated with playing the stock market is fun and exciting. They do believe that a diversified portfolio reduces risk. The research findings indicate that shareholders think they understand the relationship between investment risk and return, but in truth many do not. Although shareholders have a fairly accurate understanding of the financial risk associated with equity and fixed-income investments, the rate of return they associate with fixed-income investments is high relative to the return they associate with equity investments. Some investment terms suggest more risk to shareholders than other terms. "High-yield" evokes the most risk to shareholders, followed by "emerging growth" and "maximum-return," respectively.

FIGURE 8
Shareholders' Key Attitudes About Financial Risk
(mean score)*



*Mean score, with ten equaling strongly agree and zero equaling do not

Self-Assessment of Risk Tolerance

Mutual fund shareholders run the gamut of willingness to take financial risk. While 48 percent describe themselves as willing to take average financial risk for average gain, 28 percent say they will take above-average risk for above-average gain, and 3 percent indicate they will take substantial risk for substantial gain. At the opposite end of the spectrum, 21 percent describe themselves as unwilling to take any financial risk. Predictably, low risk-tolerant shareholders are most likely to describe themselves as unwilling to take financial risk, and high risk-tolerant shareholders are most likely to describe themselves as willing to take above-average financial risk.

Shareholders' Willingness to Take Financial Risk

Can a shareholder's tolerance for financial risk change? The research findings indicate that more than half of shareholders say their willingness to take risk has changed from the time of their first investment. Some shareholders have become more risk-averse, while others have become less risk-averse—31 percent say they are less willing to take on risk and 24 percent say they are more willing. The remaining 44 percent say their risk tolerance has not changed.

Shareholders categorized as low risk-tolerant in this study are the most apt to say they have become less willing to take on risk.[1] Shareholders categorized as high risk-tolerant are the most likely to say they have become more willing to take on risk since they first started

[1] Using shareholders' responses to six questions asked in the in-home interviews, ICI and RAC developed a score to group and analyze shareholders according to their tolerance toward investment risk. Shareholders were categorized as low, moderate, and high risk-tolerant based on their score. See Chapter 3 for a discussion of the demographic and financial characteristics of shareholders by their risk category, and see Appendix A, Research Methodology, for a detailed explanation of the construction of the risk score.

FIGURE 9

Shareholders' Willingness to Take Financial Risk

(percent of respondents)

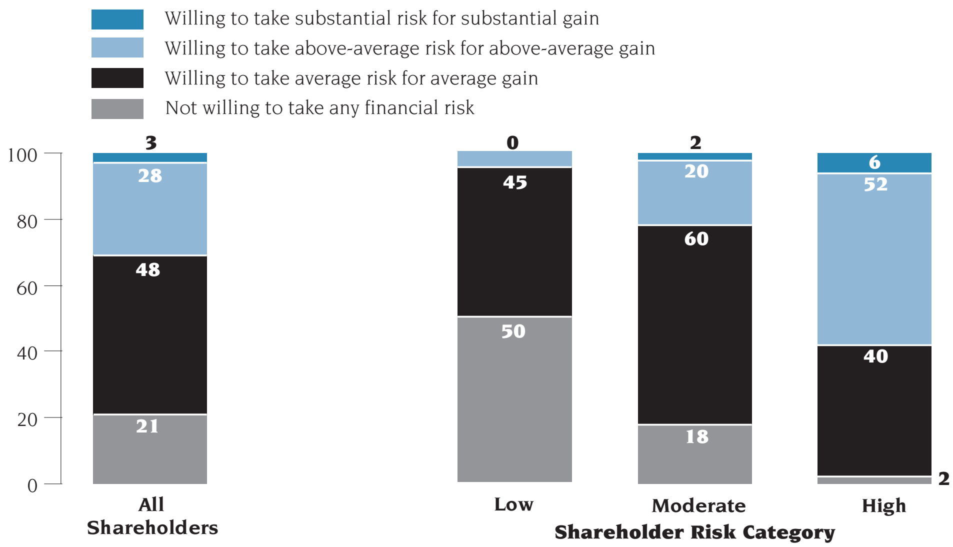


FIGURE 10

Shareholders' Attitudes About Financial Risk

(mean score)*

	All Shareholders	Shareholder Risk Category		
		Low	Moderate	High
A diversified investment portfolio reduces risk.	7.8	7.8	7.8	7.9
The older people get, the less willing they are to take investment risk.	7.6	8.6	7.5	6.7
An investment that involves a great deal of risk isn't an investment, it's gambling.	7.5	9.4	8.3	5.2
The higher the investment's yield or rate of return, the greater its associated risk.	7.5	7.8	7.5	7.2
My approach is to be cautious and avoid all risky investments.	6.4	8.6	6.8	4.2
I only invest with extra money I can afford to lose.	5.9	7.9	5.6.	4.6
The more money one has, the more investment risk one can take.	5.7	5.5	5.8	5.6
The more familiar an investment, the less risky it is.	5.5	5.7	5.7	5.1
The associated with playing the stock market its fun and exciting.	3.9	1.7	3.7	5.6

**Mean score, with ten equaling strongly agree and zero equaling do not agree*

investing. Those classified as moderately risk-tolerant are the most inclined to say that their risk tolerance has not changed over time. (See Figure 4 in the Executive Summary of Key Findings, page 5.)

Attitudes About Risk

A major objective of this study is to understand shareholders' attitudes about risk. To this end, shareholders were asked to indicate, on a scale of zero to ten, their level of agreement with a number of risk-related statements. A score of ten indicates that the shareholder strongly agrees with the statement. As the mean scores of the data indicate, attitudes about risk vary widely. In addition, the scores show that shareholders believe that: a diversified portfolio reduces risk, people become more financially conservative later in life, investing in something they consider extremely risky is comparable to gambling, and financial risk and rate of return are positively related. At the opposite end of the scale, only a few shareholders say they find the risk associated with playing the stock market fun and exciting.

Low, moderate, and high risk-tolerant shareholders equally agree that a diversified investment portfolio reduces risk. Beyond the importance of investment diversification, however, they have quite different views on financial risk. Not unexpectedly, low risk-tolerant shareholders are the most apt to say that purchasing an investment they regard as extremely risky is analogous to gambling. Members of this group also say that they prefer to avoid all investments they consider risky and that they prefer to invest only with money they can afford to lose. In contrast, high risk-tolerant shareholders are the group most likely to agree with the statement that the risk involved in playing the stock market is fun and exciting.

Investment Terms and Risk

Do some investment terms imply more risk to shareholders than others? In order to answer this question, shareholders were asked to evaluate, on a scale of zero to ten, how much risk they associate with a variety of words and phrases used by financial services companies. A score of ten indicates that the term suggests a great deal of risk.

With a mean score of 7.2, "high-yield" evokes the image of most risk to shareholders, followed by "emerging growth" at 6.9. "Maximum-return," "international," and "variable rate" each received a mean score between 6.0 and 7.0. At the other end of the scale, the terms "guaranteed investment," "fixed-rate," and "tax-free" suggest very little risk to shareholders.

With two exceptions, low, moderate, and high risk-tolerant shareholders do not differ greatly in their assessment of the level of risk suggested by the investment terms. "Maximum-return" implies more risk to moderate and high risk-tolerant shareholders. "International" suggests more risk to low risk-tolerant shareholders.

Views on Product Risk and Return

Shareholders were asked to indicate the level of risk and rate of return they associate with global equity funds, blue-chip stocks, long-term municipal bond funds, and U.S. Treasury bonds. These four investments portray different points in the risk-return spectrum, provide a mix of fixed-income and equity products, and represent a mix of pooled and individual investments.

Figure 12 illustrates that shareholders perceive the risks associated with the four products fairly accurately. They associate the two equity products with more risk than they do the fixed-income products. Among the equity products, shareholders perceive that global equity funds carry more risk than blue-chip stocks. Among the fixed-income products, they view long-term municipal bond funds as holding more risk than U.S. Treasury bonds.

In addition to the greater element of risk, shareholders also generally associate a greater potential return with equity products. However, they perceive blue-chip stocks as having a greater potential return than global equity funds, which would appear inconsistent with their assessment of the relative risks of the equity products. Shareholders also view long-term municipal bond funds as having a potential rate of return similar to U.S. Treasury bonds.

FIGURE 11

Shareholders' Perception of Risk for Selected Investment Terms by Risk Category

(mean score)*

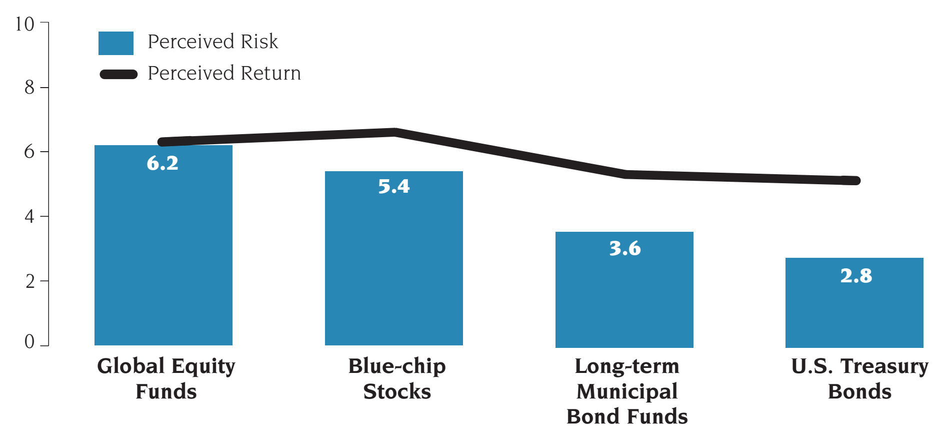
	All Shareholders	Shareholder Risk Category: Low	Moderate	High
High-yield	7.2	7.2	7.4	7.0
Emerging growth	6.9	7.0	6.8	7.0
Maximum-return	6.7	6.1	7.0	6.8
International	6.6	7.1	6.5	6.4
Variable rate	6.3	6.3	6.2	6.2
Short-term	5.5	5.5	5.7	5.0
Blue-chip	4.9	5.1	5.0	4.7
Managed portfolio	4.5	4.2	4.8	4.4
Balanced	4.3	4.2	4.3	4.2
Long-term	4.2	4.0	4.0	4.5
Tax-free	3.7	3.7	3.6	3.8
Fixed-rate	3.5	3.4	3.8	3.2
Guaranteed investment	3.2	3.2	3.3	3.0

**Mean score, with ten equaling great deal of risk and zero equaling no risk*

FIGURE 12

Shareholders' Perception of Risk and Return for Four Investments

(mean score)*



**Mean score, with ten equaling very risky or very high return and zero equaling not very risky or very low return*

Moreover, the potential return they associate with the two fixed-income investments used as examples is quite high relative to the potential return they associate with the two equity products. These findings indicate that shareholders may have unrealistic return expectations about their fixed-income investments.

In addition, shareholders were asked to indicate how well, in their opinion, global equity funds, blue-chip stocks, long-term municipal bond funds, and U.S. Treasury bonds meet the following eight investment objectives:

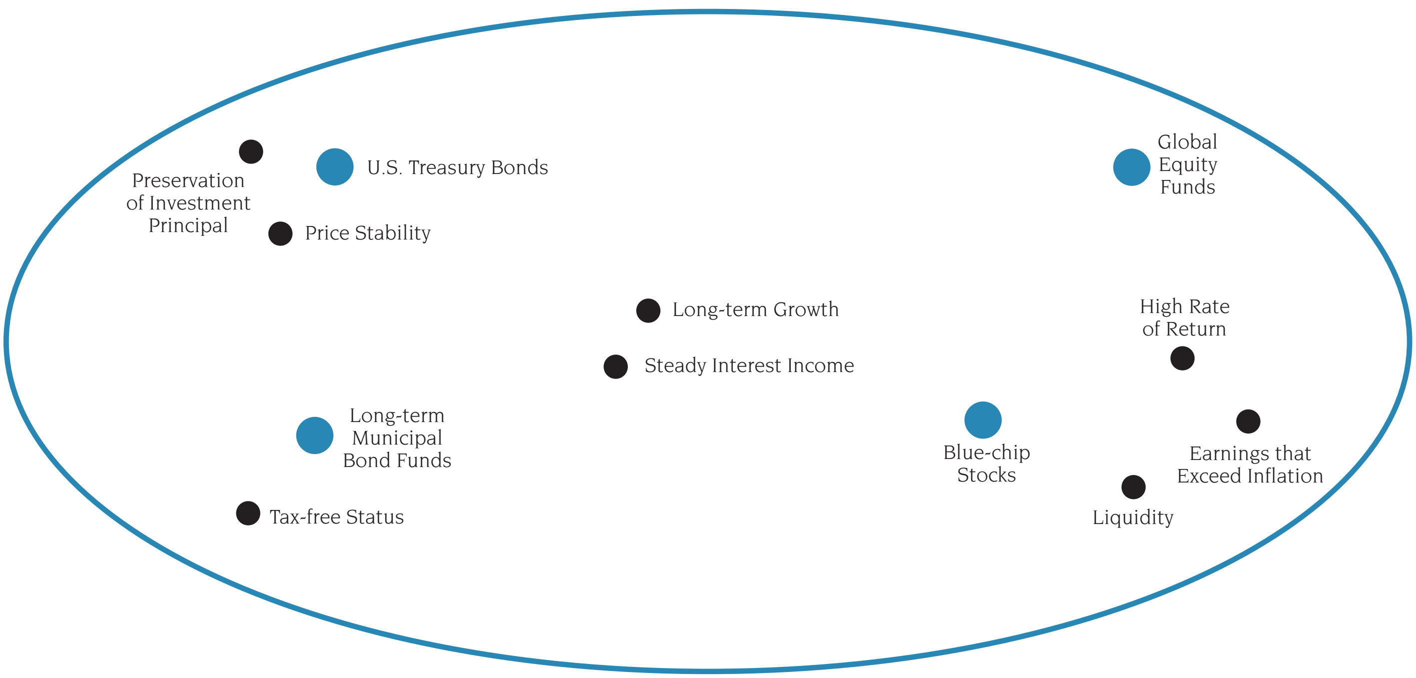
- preservation of investment principal,
- price stability,
- long-term growth,
- steady interest income,
- tax-free status,
- high rate of return,
- earnings that exceed inflation, and
- liquidity.

Perceptual mapping was used to illustrate the degree to which shareholders think the four investments meet the eight objectives. Figure 13 shows that shareholders primarily associate blue-chip stocks with high rate of return, earnings that exceed inflation, and liquidity. Shareholders tend to associate long-term municipal bonds with tax-free status, and typically link U.S. Treasury bonds with preservation of investment principal and price stability. Long-term growth and steady interest income are located in the middle of the map, an indication that shareholders perceive that all four products satisfy these two investment objectives. Except for long-term growth and steady interest income, shareholders do not associate global equity funds with any of the investment objectives.

Figure 14 depicts shareholders' perception of the liquidity of blue-chip stocks, global equity funds, long-term municipal bond funds, and U.S. Treasury bonds. Shareholders view blue-chip stocks as the most liquid investment, followed by global equity funds, U.S. Treasury bonds, and long-term municipal bond funds, respectively. However, the perception that blue-chip stocks and global equity funds provide liquidity is greatest among high risk-tolerant shareholders. Also, moderate risk-tolerant shareholders perceive long-term municipal bond funds and U.S. Treasury bonds as almost equally liquid. Low and high risk-tolerant shareholders view long-term municipal bond funds as the least liquid of all four products.

FIGURE 13

Shareholders' Association of Selected Investments with Investment Objectives



This figure illustrates how shareholders perceive eight investment objectives (black dots) for four investment products (blue dots). For instance, because they are located in the center of this diagram, long-term growth and steady investment income are associated with all four investment products. High rate of return, earnings that exceed inflation, and liquidity.
See page 54 in Appendix A, Research Methodology, for guidelines on how to interpret this map.
See Figure 53 on page 57 in Appendix B, Detailed Tabulations, for shareholders' mean scores on these items.

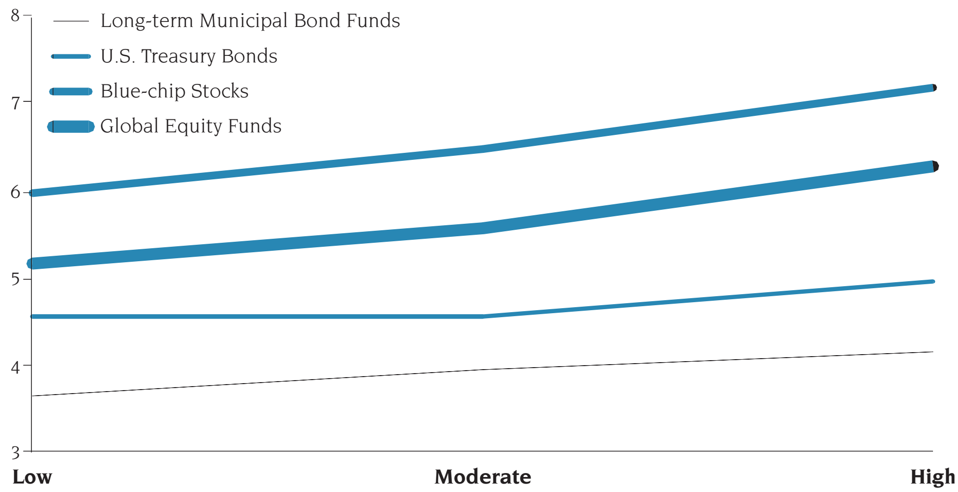
2 See Appendix A, Research Methodology, for an explanation of perceptual mapping.

Figure 15 illustrates differences in shareholders' perception of the long-term growth potential of the four products. Although not statistically significant, the differences between low, moderate, and high risk-tolerant shareholders are worth noting. On the one hand, low risk-tolerant shareholders perceive that long-term municipal bond funds and U.S. Treasury bonds provide better long-term growth opportunities than either blue-chip stocks or global equity funds. On the other hand, high risk-tolerant shareholders view blue-chip stocks as the investment that can best offer long-term growth potential and perceive long-term municipal bond funds as the investment that can least provide long-term growth.

FIGURE 14

Shareholders' Perception of Liquidity for Four Investments

(mean score)*

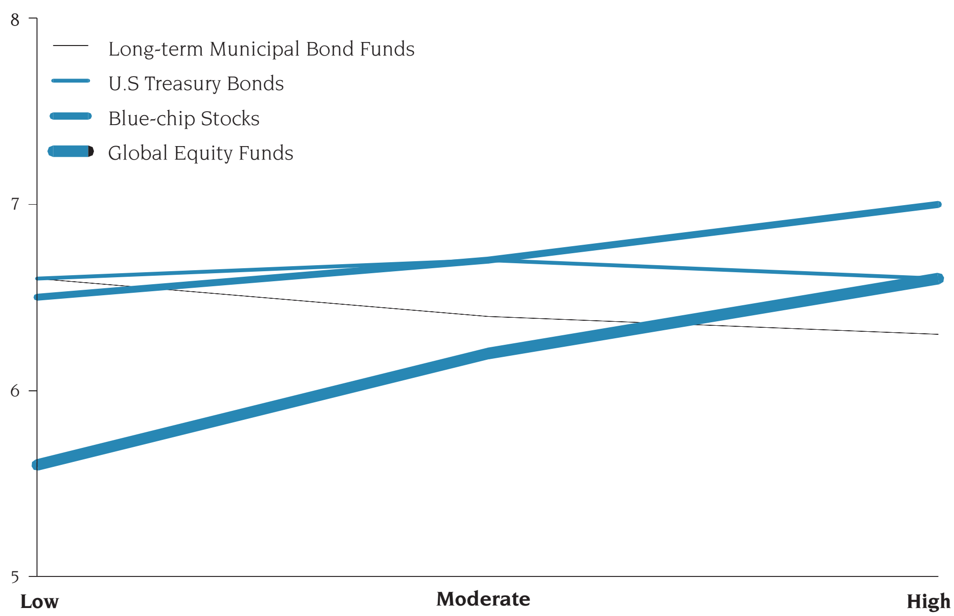


*Mean score, with ten equaling meets objective completely and zero equaling does not meet objective

FIGURE 15

Shareholders' Perception of Long-term Growth for Four Investments

(mean score)*



*Mean score, with ten equaling meets objective completely and zero equaling does not meet objective

Chapter 2

Investment Orientation

The cautious seldom err.

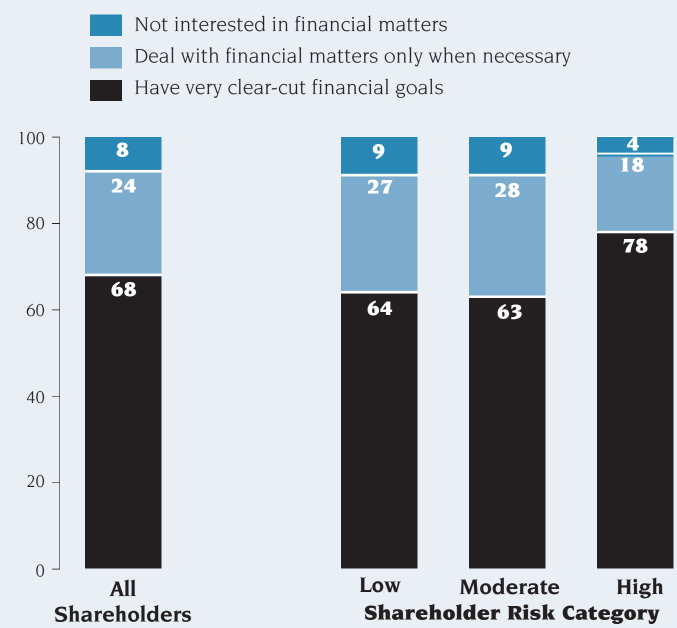
Confucius

Chapter 2. Investment Orientation

Chapter Summary

High risk-tolerant shareholders are the group most apt to describe themselves as having clear-cut financial goals. One reason has to do with their home environment. Many grew up in households that discussed and owned investments. Not surprisingly, high risk-tolerant shareholders are more likely to describe themselves as confident, involved, and independent financial decisionmakers than are low risk-tolerant shareholders. In contrast, low risk-tolerant shareholders tend to describe themselves as confused by the variety of investment choices available to them, and, consequently, typically turn to others for assistance. Although they say that a long-term approach to investing is the best strategy, low risk-tolerant shareholders are the group most likely to worry about short-term fluctuations—an interesting paradox. Low risk-tolerant shareholders also demonstrate very little knowledge of equity and fixed-income products. Predictably, high risk-tolerant shareholders have the best understanding of the principles of investing.

FIGURE 16
Shareholders' Overall Investment Orientation
(percent of respondents)



Overall Orientation

High risk-tolerant shareholders appear to be more focused investors than either their low or moderate risk-tolerant counterparts. More than three quarters of high risk-tolerant shareholders describe themselves as having very clear-cut financial goals, while less than two in ten say they focus on financial matters only when they have to. In contrast, almost two thirds of low and moderate risk-tolerant shareholders perceive themselves as having clear-cut financial goals, while nearly three in ten say they deal with financial matters only when they have to.

Investment History

In order to determine whether or not an individual's current tolerance for financial risk can be linked to his or her exposure to investing while growing up, respondents were asked several questions about their family's investment history. The findings indicate that a relationship between the two exists.

- More high risk-tolerant shareholders grew up in households that were interested in investing than did low and moderate risk-tolerant shareholders.
- Low and moderate risk-tolerant shareholders were more likely to grow up in households that did not discuss investing than were high-risk tolerant shareholders.
- When compared with high risk-tolerant shareholders, low and moderate risk-tolerant shareholders were more apt to grow up in households that did not invest.
- Low and moderate risk-tolerant shareholders were less likely than their high risk-tolerant counterparts to consider their family's investment approach successful.

High risk-tolerant shareholders also made their first investment at a slightly earlier age than either low or moderate risk-tolerant shareholders. Not surprisingly, high risk-tolerant shareholders were somewhat more apt than other shareholders to invest in individual stock, a financial product compatible with their willingness to take risk. Low risk-tolerant shareholders were more apt than other shareholders to list investment real estate as their first investment.

Attitudes About Investing

Low risk-tolerant shareholders have an investment philosophy that is different in some respects from the investment philosophy of moderate and high risk-tolerant shareholders. Although the differences are not statistically significant, when compared with their moderate and high risk-tolerant counterparts, low risk-tolerant shareholders are more likely to prefer tax-advantaged investments, are less concerned that their investments keep pace with inflation, and are more concerned about short-term fluctuations. This last finding is especially interesting because low risk-tolerant shareholders agree just as strongly as moderate and high risk-tolerant shareholders that the best way to make money is to adopt a long-term strategy.

As Figure 17 shows, shareholders' knowledge of investing and involvement in their personal finances differ considerably according to their risk tolerance. The more tolerant shareholders are of financial risk, the more closely they follow their investments, the more pleasure they obtain from managing their savings and investments, and the more likely they are to make their own investment decisions. The less tolerant shareholders are of risk, the less they know about investing, and the more confused they are by the investment options available to them.

Not surprisingly, low risk-tolerant shareholders are the most adviser-dependent group. When compared with their moderate and high risk-tolerant counterparts, low risk-tolerant shareholders are more likely to indicate that a broker or financial planner recommended some of their best investments. Low risk-tolerant shareholders are also the group most likely to agree that a broker can decide the best investment risk level for them.

Investment Knowledge

As the findings presented in Figure 17 indicate, many shareholders say they know quite a bit about investing, especially those that fall into the high risk-tolerant category. How much do shareholders actually know about different types of investments, particularly their inherent risks? To

FIGURE 17

Shareholders' Attitudes on Investing

(mean score)*

	All Shareholders	Shareholder Risk Category		
		Low	Moderate	High
Investment Strategies				
The best way to make money is to adopt a long-term strategy.	8.2	8.2	8.0	8.3
I try to make sure that my investments keep pace with inflation.	7.4	6.8	7.6	7.7
I prefer investments that offer tax advantages.	7.3	7.6	7.2	7.1
I'm not too concerned if my long-term investments fluctuate in the short term	7.0	6.3	7.0	7.3
Investment Involvement and Knowledge				
I follow the value of my investments closely.	6.4	5.6	6.3	7.1
There are too many investments; it's hard to tell which ones are good.	6.2	6.7	6.2	5.8
I enjoy managing my savings and investments.	5.9	5.0	5.5	7.0
Most investments are too complicated to understand.	5.1	5.8	5.5	4.1
I can make my own investment decisions without advice from others.	4.6	4.2	4.3	5.2
I know more about investing than most people.	4.5	3.9	4.5	5.2
Views on Brokers				
Some of my best investments were recommended to me by my broker or financial planner.	5.2	5.7	5.1	5.0
My broker decides the best investment risk level for me.	3.7	4.6	3.9	2.9

**Mean score, with one equaling strongly agree and zero equaling do not agree* answer this question, shareholders were asked to indicate their level of agreement with several statements that were designed to determine how well investors understand the underlying risks of equity and fixed-income investments.

Figure 18 illustrates that the investment knowledge of shareholders is not especially strong. In fact, shareholders' knowledge of fixed-income products is particularly weak. The statement that investors should choose bonds with long maturities for a low-risk bond investment received a mean score of 5.7. In general, the longer the maturity of a bond or the average weighted maturity of a bond fund portfolio, the greater the variability of the price of the bond in response to changes in interest rates. Thus, bonds carry the risk that their prices will decline as interest rates rise (even though the principal amount outstanding doesn't change), and for a given increase in the interest rate, long-term bonds will experience a greater decline in market price than short-term bonds.

The statement that investors should look for the highest quality bonds in order to achieve the highest possible return in bonds received a mean score of 6.4. Generally, the higher a bond's quality rating, the lower its rate of return.

The data show that high risk-tolerant shareholders have a better understanding of investment principles than do either low or moderate risk-tolerant shareholders. For example, high risk-tolerant shareholders are more knowledgeable about the relationship between credit ratings and yields. They are also more likely to understand that investing in a bond fund does not provide safety of principal.

FIGURE 18

Shareholders' Investment Knowledge

(mean score)*

	All Shareholders	Shareholder Risk Category		
		Low	Moderate	High
Equity Investments				
In the long run, individual stocks are the best place for my money.	4.3	3.7	4.2	4.8
Over time, stocks have not done as well as putting money in a CD and letting it earn interest.	3.6	4.7	3.5	2.8
Fixed-Income Investments				
For the highest possible return in bonds, look for ones with the . highest quality rating	6.4	7.0	6.4	5.7
Choose bonds with long maturities for a low-risk bond investment.	5.7	5.8	5.6	5.7
A bond fund can always be sold for the same price for which it was purchased.	3.2	3.4	3.5	2.8

**Mean score, with ten equaling strongly agree and zero equaling do not agree*

Chapter 3

Investment Profile

Take calculated risks. That is quite different from being rash.

George S. Patton

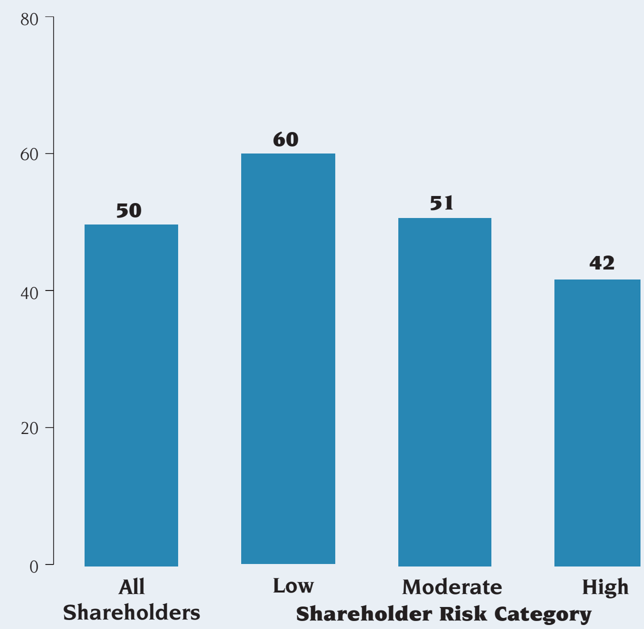
Chapter 3. Investment Profile

Chapter Summary

In many instances, the content of a shareholder's portfolio reflects his or her tolerance for financial risk, and in other instances the content shows contradiction. High risk-tolerant shareholders, for example, are the group most likely to own stock funds and individual stocks. At the same time, 60 percent of low risk-tolerant shareholders own individual stock and nearly half own stock funds.

The sources shareholders contact for investment information reflect their level of self-reliance about financial matters. High risk-tolerant shareholders, who are very self-reliant about investing, are the most inclined to read a magazine or newspaper article for investment information. Low and moderate risk-tolerant shareholders are more likely to turn to friends, family, and business associates for investment advice and guidance. Regardless of their risk tolerance level, however, shareholders uniformly indicate that a fund's performance history is the most important piece of information they require before purchasing fund shares.

FIGURE 19
Shareholders' Age by Risk Category
(median)



Demographic and Financial Characteristics

Tolerance toward financial risk appears to be related to a variety of demographic factors, including age, income, retirement status, education, and gender. In fact, proximity to retirement seems to be the driving factor. As Figure 20 shows, risk tolerance declines as shareholder age increases. High risk-tolerant shareholders have a median age of 42 years, compared with a median of 60 years for low risk-tolerant shareholders, and 51 years for moderate risk-tolerant shareholders. Because high risk-tolerant shareholders are younger and are in their peak earning years, they are more likely to be employed than retired, and tend to have greater household incomes than their low and moderate risk-tolerant counterparts. Nevertheless, high risk-tolerant shareholders have the lowest amount of household financial assets.

As a group, high risk-tolerant shareholders are the most educated. Two thirds of high risk-tolerant shareholders have at least a four-year college degree, compared with 39 percent of low risk-tolerant shareholders and 57 percent of moderate risk-tolerant shareholders. The research findings also indicate that male shareholders are more willing to accept financial risk than female shareholders. Almost six in ten high risk-tolerant shareholders are men, compared with 39 percent of low risk-tolerant shareholders and 46 percent of moderate risk-tolerant shareholders.

The more risk shareholders will tolerate, the more emphasis they place on long-term investment growth. Among low risk-tolerant shareholders, preservation of principal is a primary investment objective, which is not a surprise because many are retirees who depend on their savings for income. Moreover, considering low risk-tolerant shareholders tend to be older and want to preserve their investment principal, it is not surprising that they are more likely to cite preserving their accumulated assets as their primary financial goal rather than saving for retirement. In contrast, moderate and high risk-

FIGURE 20

Shareholders' Demographic and Financial Characteristics by Risk Category*

	All Shareholders	Shareholder Risk Category		
		Low	Moderate	High
Median age (in years)	50	60	51	42
Median household income	$60,300	$51,400	$61,200	$66,100
Median household financial assets**	$70,100	$69,500	$100,700	$62,000
Average number of financial dependents,	2.4	2.1	2.4	2.7
Percent of Respondents				
Male	48%	39%	46%	58%
Married	78	69	77	85
Widowed	8	17	8	2
Employed full- or part-time	67	50	68	80
Retired from lifetime occupation	31	53	31	15
Spouse employed***	71	61	75	73
Four-year college degree or more	54	39	57	66
Graduate degree	23	22	24	25
Primary investment objective:				
Long-term growth	29	18	30	36
Preservation of investment principal	21	29	21	12
Primary financial goal				
Saving for retirement	32	17	36	38
Preserving accumulated assets	20	37	16	14

** Respondents were either the household's primary or cofinancial decisionmaker.*
***Excluding real estate*
****Percent of married respondents*

tolerant shareholders most often mention saving for retirement as their primary financial goal.

Current Investment Portfolio

Low and high risk-tolerant shareholders own a median of two mutual funds per household while moderate risk-tolerant shareholders usually own three per household. Sixty-one percent of low risk-tolerant shareholders own money market funds, 49 percent own stock funds, 29 percent own balanced funds, and 26 percent own bond funds. When compared with their low risk-tolerant counterparts, moderate and high risk-tolerant shareholders are more apt to own stock funds. More than six in ten moderate and high risk-tolerant shareholders own stock funds. Roughly four or five out of ten in each of these two groups own money market funds. Even though moderate risk-tolerant shareholders are the group most apt to own balanced funds and bond funds, only about three or four in ten own them.

About two thirds of all responding shareholders own sales force-distributed funds. Exhibiting their

FIGURE 21

Mutual Fund Ownership by Risk Category

	All Shareholders	Shareholder Risk Category		
		Low	Moderate	High
Median number of funds owned per household	2	2	3	2
Percent of Respondent Households				
Own:*				
Stock funds	60%	49%	62%	66%
Money market funds	49	61	43	48
Balanced funds	34	29	40	32
Bond funds	30	26	35	28
Have:*				
Sales force-distributed funds	65	64	66	66
Direct-marketed funds	39	36	34	45

**Multiple responses included*

greater financial self-reliance, more high risk-tolerant shareholders own direct-marketed funds than do low or moderate risk-tolerant shareholders.

In addition to mutual funds, responding shareholders also own an average of 4.5 other types of investments per household. The two most frequently held nonfund investments among responding shareholders are individual stocks and money market deposit accounts. Not surprisingly, high risk-tolerant shareholders are the most likely to own individual stocks. As Figure 22 shows, low risk-tolerant shareholders are somewhat more likely to own individual corporate and municipal bonds than their moderate and high risk-tolerant counterparts. Moderate risk-tolerant shareholders are the group most apt to own both fixed and variable annuities. Similar proportions of low and high risk-tolerant shareholders own investment real estate and U.S. Treasury bonds, bills, and notes, an indication that shareholders do not always own investments that match their tolerance for risk.

Investment Information Needs

Regardless of their risk tolerance level, shareholders say they consider a fund's performance history as the most important piece of information they want to know before deciding to purchase fund shares. Curiously, even though low risk-tolerant shareholders tend to describe themselves as uninvolved in their personal finances, they put considerably more weight than other shareholders on knowing the name and background of the fund's portfolio manager. Low risk-tolerant shareholders also put greater emphasis on current yield than do either moderate or high risk-tolerant shareholders.

The shareholders surveyed contact a variety of sources for information

FIGURE 22

Ownership of Nonfund Investments by Risk Category

	All Shareholders	Shareholder Risk Category		
		Low	Moderate	High
Average number of nonfund * investment types owned	4.5	4.6	4.6	4.2
Percent of Respondents Owning**				
Individual stocks	60%	60%	54%	67%
Money market deposit account	54	56	55	50
Certificates of deposit	42	46	47	31
U.S. savings bonds	38	35	38	40
Investment real estate	26	25	24	29
Tangible investments	25	28	25	25
Fixed annuity	23	19	30	18
Individual municipal bonds	15	20	14	12
Variable annuity	15	11	21	12
U.S. Treasury bonds, bills, and notes	14	13	18	12
Individual corporate bonds	12	17	10	10
Options	10	8	12	8
Unit investment trust	6	10	6	4

** Indiviudal stocks and certificates of deposit are examples of different investment types.*
***Multiple responses included*

FIGURE 23

Information Important to the Mutual Fund Investment Decision*
(percent of respondents indicating very important)

	All Shareholders	Shareholder Risk Category		
		Low	Moderate	High
Fund performance history	87%	92%	86%	84%
Fund company reputation	82	85	81	80
Current yield	78	88	80	69
Annual expenses or fees	65	66	63	65
Investment philosophy of the fund company	59	60	54	63
Fund portfolio's investment holdings	57	57	54	58
Commission or sales charge	55	59	52	54
Name and background of fund portfolio manager	41	51	38	36

**Multiple responses included*

on mutual funds and other financial products. However, the source they turn to most often reflects their level of self-reliance about financial matters, an indication that mutual fund communications strategies may need to be tailored to specific groups.

Low and moderate risk-tolerant shareholders, who are not very self-reliant investors, are most likely to approach friends, family, and business associates for investment information. They are also more likely to consult with an accountant or a tax specialist than are high risk-tolerant shareholders. In contrast, high risk-tolerant shareholders, who tend to be self-reliant investors, are most apt to obtain investment information from a magazine or newspaper article and to take advantage of information offered by their broker. Further exhibiting their independence in financial matters, high-risk tolerant shareholders are more likely to read a mutual fund prospectus or an investment newsletter than are other shareholders.

FIGURE 24

Sources Shareholders Contact for Investment Information*

(percent of respondents)

	All Shareholders	Shareholder Risk Category		
		Low	Moderate	High
Friends, family, business associates	45%	43%	51%	40%
Full-service broker	39	38	38	44
Newspaper or magazine articles	30	20	25	46
Independent financial planner	30	32	30	29
Bank or trust officer	29	31	31	24
Mutual fund prospectus	26	13	25	38
Accountant or tax specialist	23	30	23	18
Brochures from banks, mutual fund companies, or brokerage houses	22	11	29	25
Investment newsletters	20	15	19	26
Magazine, newspaper, television advertising	18	7	21	24
Investment seminars	15	10	17	16
Financial programs on television	13	6	15	18
Discount broker	11	3	16	13
Insurance agent	11	7	11	13
Mutual fund company toll-free number	11	1	15	14

**Multiple responses included*

Chapter 4

Segmentation of Shareholder Attitudes Toward Risk

And indeed there will be time to wonder "Do I dare?"
and, "Do I dare?"

T.S. Eliot

Chapter 4. Segmentation of Shareholder Attitudes Toward Risk

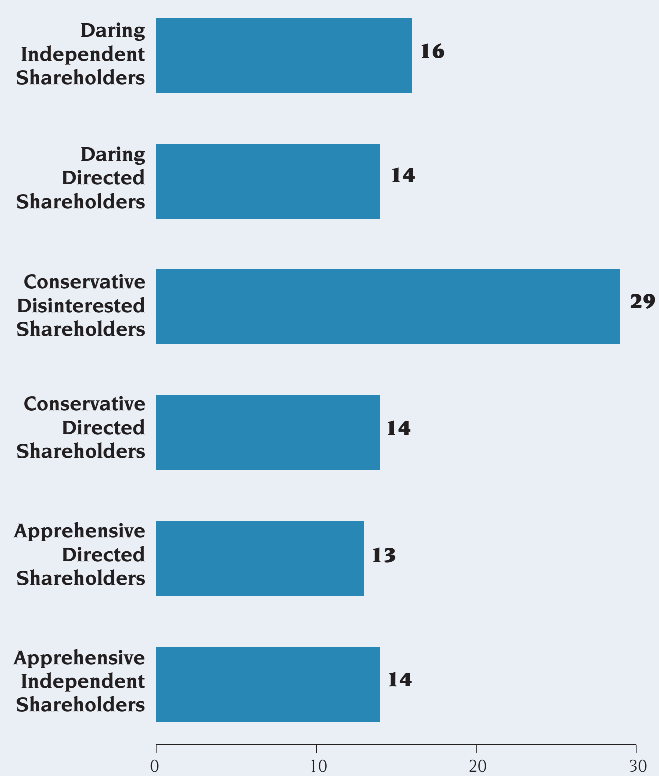
Chapter Summary

The analysis in the first three chapters grouped shareholders into three categories based on a risk tolerance score. Chapter 4 uses segmentation analysis to classify shareholders with similar attitudes toward financial risk and investing based on the respondents' answers to 41 statements.[3] The analysis produced six clusters, or segments:

- *Daring Independent Shareholders*. Shareholders in this group are not afraid to take financial risk and prefer to make their own financial decisions. They have little need for professional investment advice.
- *Daring Directed Shareholders*. Also not afraid to take financial risk, but not as knowledgeable about investing as Daring Independent Shareholders, Daring Directed Shareholders tend to rely on financial professionals for investment advice.
- *Conservative Disinterested Shareholders*. Willing to take some financial risk, members of this group are not at all captivated by investing. They view investing simply as a means to an end.
- *Conservative Directed Shareholders*. Conservative Directed Shareholders are somewhat cautious about taking financial risk and have a strong need for professional investment advice.
- *Apprehensive Directed Shareholders*. They are very cautious about taking financial risk. Like Conservative Directed Shareholders, Apprehensive Directed Shareholders have a strong need for personal guidance.
- *Apprehensive Independent Shareholders*. Apprehensive Independent Shareholders are fairly cautious about taking financial risk. Even though they say they feel inundated by the investment choices that surround them, shareholders in this group say they have no need for professional investment advice.

The segmentation analysis provides mutual fund companies with a better understanding of shareholders' knowledge of and views on financial risk, as well as with the information needed to build risk-related communications strategies targeted toward specific groups of shareholders.

FIGURE 25
Market Share of Shareholder Segments
(percent of respondents)



[3] See Figures 55 and 56 in Appendix B for a complete list of the attitude statements and the mean score of each for the six segments described in this chapter.

FIGURE 26

Underlying Risk and Investment Dimensions Based on Respondent Attitudes

1. Cautious About Taking Risk

"My approach is to be cautious and avoid all risky investments."

"An investment that involves a great deal of risk isn't really an investment, it's gambling."

2. Only Invest with Extra Money

"I only invest with extra money I can afford to lose."

"The more money you have, the more risk you can take with your investments."

3. Believe Knowledge Reduces Risk

"The more familiar you are with an investment,, the less risky it is."

4. Stock-oriented Investment Approach

"Blue-chip stocks are always good investments."

"In the long run,, individual stocks are the best place for my money."

5. Bond-oriented Investment Approach

"Bond mutual funds are the best way to get a high rate of return."

6. Involved in Investment Decisions

"I enjoy managing my savings and investments."

"I follow the value of my investments closely."

7. Need for Professional Investment Advice

"Some of my best investments were recommended to me by my broker or financial planner.

"My broker decides the best risk level for me."

8. Confused by Investments

"There are too many types of investments; it's hard to tell which ones are really good."

"Most investments are too complicated to understand."

9. Comfortable with Mutual Funds

"Mutual funds provide the widest diversification possible."

"Mutual fund managers can do a better job of investing than most people can do by themselves."

Segmentation divides markets into groups according to similar characteristics, such as demographics, purchasing habits, motivations, needs, and attitudes. In this study, segmentation analysis was used to group shareholders with similar attitudes toward financial risk and investing. To determine shareholder attitudes as well as to classify their responses, respondents were asked to indicate their level of agreement with 41 statements about risk and investing. Using factor analysis to analyze the data, nine particular elements emerged.[4] The nine elements represent the underlying dimensions of the survey data and are described in Figure 26.

Using the nine underlying risk and investment dimensions, mutual fund shareholders were divided into six groups, or segments.[5] Each segment has been given a name that describes the overall disposition of the individuals in that group. The descriptions relate to shareholder attitudes about financial risk and investing, and represent their views on mutual funds and other investments. The six segments are:

- Daring Independent Shareholders,
- Daring Directed Shareholders,
- Conservative Disinterested Shareholders,
- Conservative Directed Shareholders,
- Apprehensive Directed Shareholders, and
- Apprehensive Independent Shareholders.

The characteristics of each of the six segments are described in the following pages. Figures 45, 46, and 47 at the end of the chapter summarize the key characteristics of each segment. The mean factor scores for the nine underlying risk and investing dimensions are depicted for each shareholder segment. A mean factor score is the value of each underlying dimension for all respondents that comprise a segment. The mean factor scores identify the degree to which each attribute describes each segment relative to the other segments. Each attribute, or factor, is an independent variable. Hence, the factors do not indicate that one particular dimension is any more or less important than another in describing each segment.

In Figure 27, for example, Daring Independent Shareholders have a high positive mean factor score for "comfortable with mutual funds," meaning that, when compared with other segments, Daring Independent Shareholders can be described as comfortable with mutual funds. In contrast, Daring Independent Shareholders have a high negative mean factor score for "confused by investments," meaning that, when compared with other segments, Daring Independent Shareholders are not confused by investments. Because factors such as "comfortable with mutual funds" and "confused by investments " are independent of one another, the analysis does not indicate which is the better description of a particular segment.

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4 See Appendix A, Research Methodology, for an explanation of factor analysis.

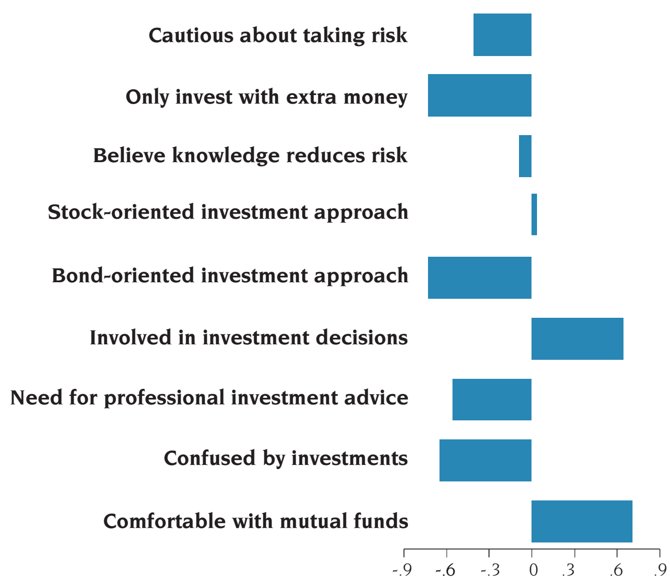
5 Considering the sample size, six segments is high. However, many of the differences among the groups would have been lost if the segments had been further consolidated. Hence, while few of the differences are statistically significant, they may be significant from a marketing standpoint.

Daring Independent Shareholders

Overview of Daring Independent Shareholders

Daring Independent Shareholders are not afraid to take financial risk. More stock-oriented than bond-oriented in their investment approach, they tend to make their own financial decisions and have little need for professional investment advice. Daring Independent Shareholders have a solid understanding of different investments and are quite comfortable with mutual funds. Not surprisingly, Daring Independent Shareholders are the segment most likely to own direct-marketed funds. Because they are typically in their mid-forties, Daring Independent Shareholders primarily are saving for retirement and are concerned with attaining investment earnings that exceed inflation. More than any other group, Daring Independent Shareholders obtain investment information from magazine and newspaper articles, mutual fund prospectuses, and investment newsletters.

FIGURE 27
Underlying Risk and Investment Dimensions of Daring Independent Shareholders
(mean factor scores)



Daring Independent Shareholders account for 16 percent of all shareholders and are the segment most willing to take financial risk in exchange for financial return. In fact, almost 50 percent of Daring Independent Shareholders say that they are willing to take at least an above-average financial risk in order to obtain at least an above-average return. Similar to other segments, Daring Independent Shareholders believe that a diversified portfolio reduces risk. When compared with other segments, however, Daring Independent Shareholders are the least apt to agree that purchasing an investment they consider extremely risky is analogous to gambling. Also indicative of their risk-tolerant nature, Daring Independent Shareholders are the segment least likely to say that their investment approach is to be cautious and avoid investments they believe are risky. Moreover, Daring Independent Shareholders say they do not invest only with money that they can afford to lose.

Words and phrases used by financial professionals can also imply risk to investors. To Daring Independent Shareholders, "high-yield," "emerging growth," and "maximum-return" denote a similar level of risk. Furthermore, they associate more risk with the phrase "maximum-return" than do other shareholder segments.

Daring Independent Shareholders are active, self-confident investors. They say they understand the stock market and how to invest. As their name suggests, Daring Independent Shareholders make their own investment decisions. They prefer to determine their own tolerance for financial risk rather than rely on a broker's assessment. Daring Independent Shareholders enjoy managing their finances and watch the value of their investments closely. More than any other segment, Daring Independent Shareholders are saving and investing for retirement. Toward that goal, they are primarily concerned that their investment earnings exceed inflation. They are not bothered by short-term fluctuations in their long-term investments.

Including other members of their households, Daring Independent Shareholders own a median of two mutual funds; 65 percent own stock funds. More than four in ten own money market funds and balanced funds. Indicative of their comfort with investments that tend to carry more risk, only 22 percent of Daring Independent Shareholders own bond funds, the lowest proportion of all the segments. Not surprisingly, they are the segment most likely to own direct-marketed funds; 57 percent own funds bought through this channel.

On average, Daring Independent Shareholders own 4.5 types of nonfund investments per household.[6] More than 60 percent own individual stocks, a financial product compatible with their self-reliant nature. Nearly four in ten Daring Independent Shareholders own investment real estate, the highest among the six groups.

Not surprisingly, Daring Independent Shareholders actively research investment opportunities. They are more apt to turn to a magazine article or to a mutual fund prospectus for investment information than they are to another person. Moreover, Daring Independent Shareholders rely on their families, friends, and business associates for investment information more often than any type of investment professional.

Most Daring Independent Shareholders are men in their mid-forties. Nearly two thirds of these investors have at least a four-year college degree, and 20 percent have a graduate degree. Perhaps because they are one of the younger segments, Daring Independent Shareholders are not as affluent as other groups, having a median household income of $64,400 and median household financial assets of $62,300.

FIGURE 28

Daring Independent Shareholders' Primary Investment Objective

(percent of respondents)

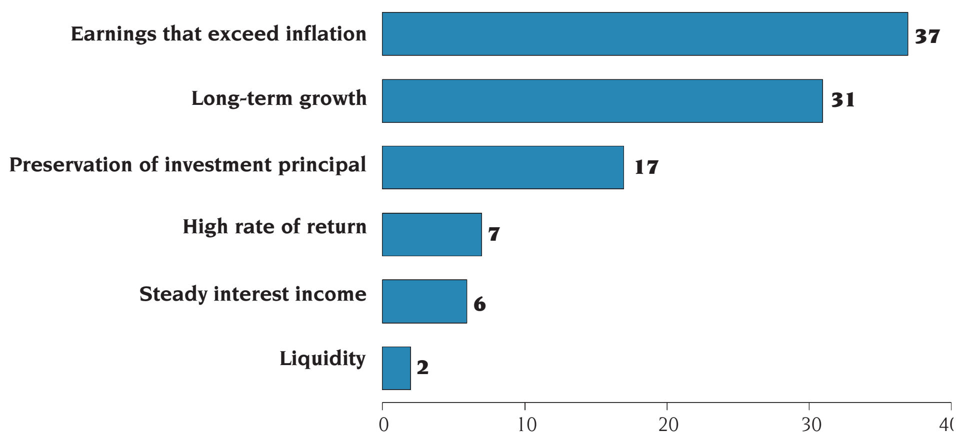
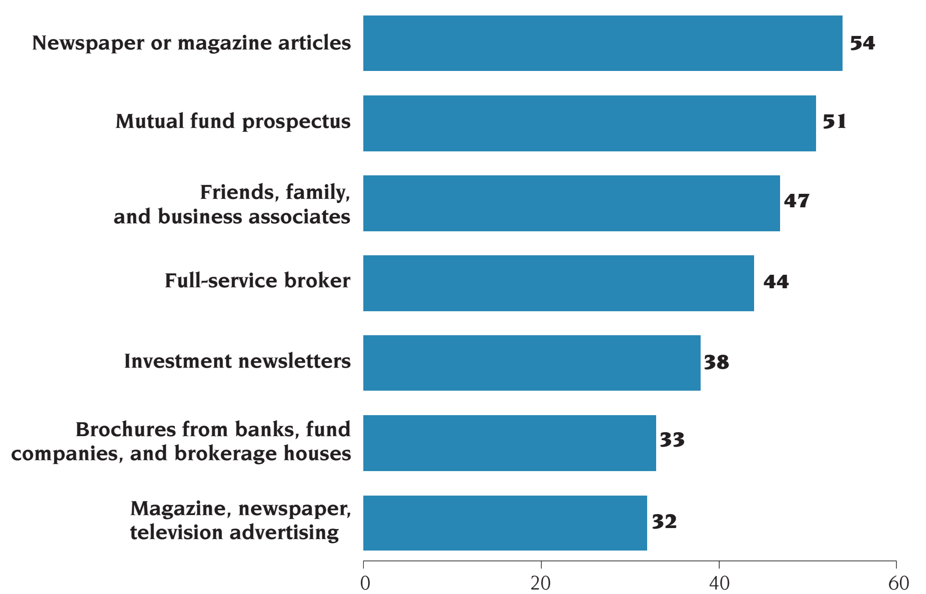


FIGURE 29

Key Sources Daring Independent Shareholders Contact for Investment Information*

(percent of respondents)



**Multiple responses included*

6 Individual stocks and certificates of deposit are examples of nonfund investment types.

Daring Directed Shareholders

Overview of Daring Directed Shareholders

The myriad of investment opportunities available to investors tends to confuse Daring Directed Shareholders and, therefore, they tend to rely on financial professionals for investment recommendations. Daring Directed Shareholders prefer to invest only with money they can afford to lose, but say they are willing to tolerate higher risk for a potentially higher reward. They are not especially comfortable with mutual funds, although their households own a median of three. Daring Directed Shareholders are active investors who like diversification. They have the most varied investment portfolio of the six segments.

FIGURE 30

Underlying Risk and Investment Dimensions of Daring Directed Shareholders

(mean factor scores)

Daring Directed Shareholders represent 14 percent of the shareholder population. More than one third say they are willing to take above-average financial risk for above-average financial gain; another 9 percent of these shareholders, the largest proportion of all segments, say they are willing to take substantial financial risk in the hope of achieving substantial financial gain. While Daring Directed Shareholders view themselves as financial risk-takers, they prefer to invest only with money they can afford to lose. Similar to other shareholder segments, Daring Directed Shareholders agree that a diversified portfolio reduces risk. Daring Directed Shareholders associate more risk with the terms "managed portfolio" and "tax-free" when compared with other segments.

Above all, their active trading distinguishes Daring Directed Shareholders from other shareholder segments. Members of this cluster are the most likely to say they constantly shift their investments around in order get the best return, even though they say they believe a long-term investment strategy is best. Similar to Daring Independent Shareholders, they enjoy managing their finances and they follow their investments closely. As their name suggests, however, Daring Directed Shareholders tend to rely on investment professionals for financial advice. In fact, most members of this segment say that a broker or financial planner recommended some of their best investments. One reason for their dependence on investment professionals is that Daring Directed Shareholders often find it hard to select the most appropriate financial product.

Daring Directed Shareholders own a median of three mutual funds per household. Similar to Daring Independent Shareholders, the largest proportion of this group, 69 percent, owns stock funds. More than a third own money funds and balanced funds, and 28 percent own bond funds. Reflecting their need for financial advice, 82 percent of Daring Directed Shareholders own sales force-distributed funds and just 22 percent own direct-marketed funds.

In the Daring Directed category, shareholders own an average of 5.1 types of nonfund investments per household, more than any other segment. Moreover, Daring Directed Shareholders are the segment most likely to own individual stocks and options, financial products that fit well with their stated risk preferences.

Exhibiting their dependence on investment professionals, Daring

Directed Shareholders are most apt to turn to a full-service broker for financial information. They also obtain investment information somewhat regularly from friends, family, and business associates, as well as from newspapers and magazines. When compared with Daring Independent Shareholders, however, Daring Directed Shareholders are less likely to tap a broad range of informational sources. They are particularly less likely to conduct their own investment analysis by reading a mutual fund prospectus or a brochure from a bank, fund company, or brokerage house.

With a median age of 49 years, Daring Directed Shareholders are typically three years older than Daring Independent Shareholders. More than half of Daring Directed Shareholders have been to college, but only 16 percent have a graduate degree. Daring Directed Shareholders have a median household income of $70,200, the highest of all the segments. This segment's $100,600 median household financial assets ranks second among all shareholder segments. More than a quarter of Daring Directed Shareholders say that their investment portfolio's performance has exceeded their expectations.

FIGURE 31

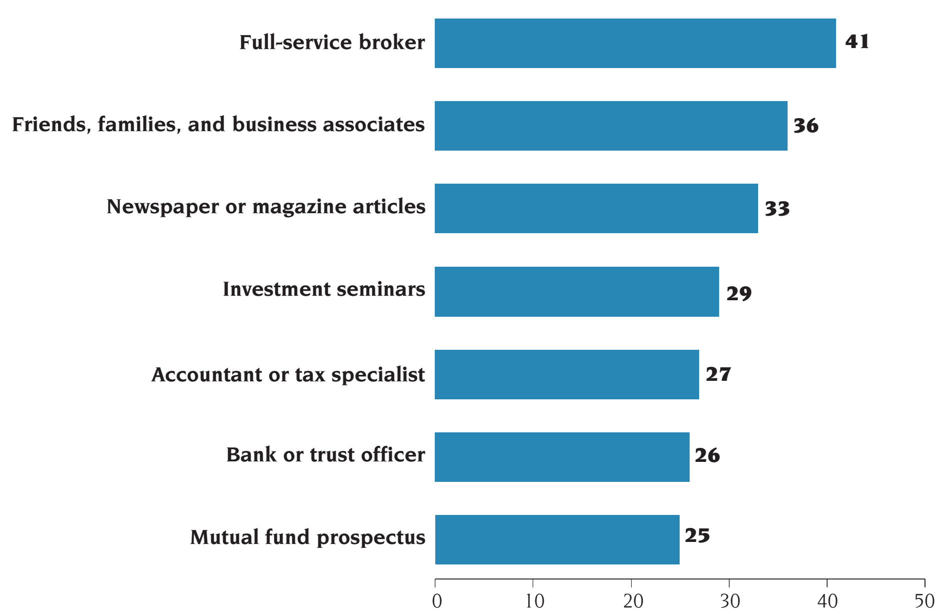
Daring Directed Shareholders' Primary Investment Objective

(percent of respondents)

FIGURE 32

Key Sources Daring Directed Shareholders Contact for Investment Information*

(percent of respondents)



**Multiple responses included*

Conservative Disinterested Shareholders

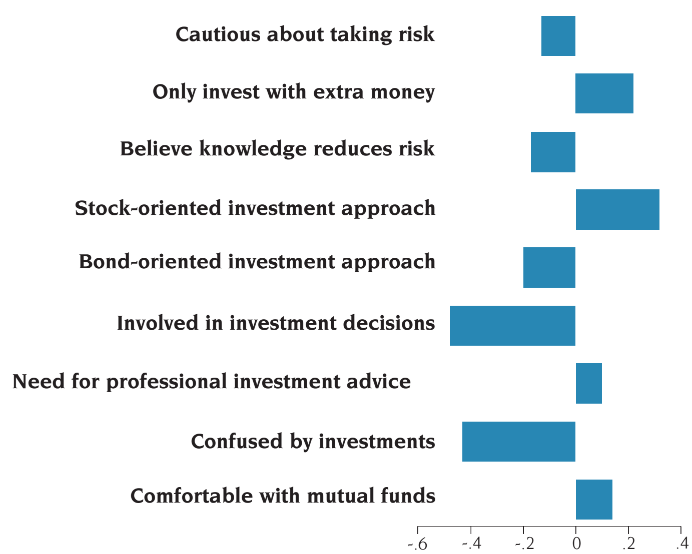
Overview of Conservative Disinterested Shareholders

Conservative Disinterested Shareholders are not at all captivated by investing. They do not enjoy managing their investment portfolios nor do they follow the value of their investments closely. While not at all involved in making financial decisions, they do not have a strong need for professional investment advice. Conservative Disinterested Shareholders perceive themselves as fairly knowledgeable about investing and are somewhat comfortable with mutual funds. They are willing to take some financial risk. More stock- than bond-oriented in their investment approach, Conservative Disinterested Shareholders' primary investment objective is ,most often, long-term growth. Conservative Disinterested Shareholders, of whom a third hold a graduate degree, are the most educated segment. This group usually depends on friends, family, and business associates for investment information.

FIGURE 33

Underlying Risk and Investment Dimensions of Conservative Disinterested Shareholders

(mean factor scores)



Comprising 29 percent of the shareholder population—the largest cluster—most Conservative Disinterested Shareholders say they are willing to take an average amount of financial risk in order to achieve an average financial gain. Reflecting their financially cautious nature, Conservative Disinterested Shareholders prefer to invest only with money they can afford to lose. They do not consider playing the stock market fun and exciting. Similar to other segments, however, Conservative Disinterested Shareholders recognize that a diversified investment portfolio reduces risk and that safe investments are not necessarily those insured by the federal government. "High-yield" is an investment term than connotes more risk to Conservative Disinterested Shareholders than "maximum-return," "emerging growth," or "international."

As their name suggests, Conservative Disinterested Shareholders are not at all captivated by investing. For this segment, investing appears to be merely a means toward an end. For example, they do not enjoy managing their investment portfolio and do not follow the value of their investments closely. Even though Conservative Disinterested Shareholders want to obtain long-term financial gains, they are not overly concerned about whether or not their investments keep pace with inflation—another sign of their general lack of interest.

Conservative Disinterested Shareholders own a median of two mutual funds per household. Supporting the notion that stock mutual funds can meet the needs of financially cautious investors, 66 percent of Conservative Disinterested Shareholders own stock funds. Almost 60 percent own money market funds, and less than 30 percent own balanced funds or bond funds. Conservative Disinterested Shareholders are more apt to purchase sales force-distributed funds than direct-marketed funds.

Altogether, Conservative Disinterested Shareholders and other members of their households own an average of 4.5 types of nonfund investments. Nearly two thirds own individual stocks, and 36 percent own certificates of deposit.

Exhibiting their indifference toward investing, Conservative Disinterested Shareholders are not especially active seekers of investment information, a finding that indicates they may be a hard-to-reach market segment. Conservative Disinterested Shareholders usually depend on friends, family, and business associates for investment information rather than on investment professionals such as full-service brokers, independent financial planners, or bankers. Although a third have turned to a newspaper or magazine article for financial information, when compared with other segments such as the Daring Independent Shareholders, Conservative Disinterested Shareholders are less likely to consult published information.

The most educated segment, more than a third of Conservative Disinterested Shareholders have a graduate degree. With a median household income of $66,000 and median household financial assets of $68,100, Conservative Disinterested Shareholders are not as affluent as several other shareholder segments, including Daring Independent Shareholders and Daring Directed Shareholders.

FIGURE 34

Conservative Disinterested Shareholders' Primary Investment Objective

(percent of respondents)

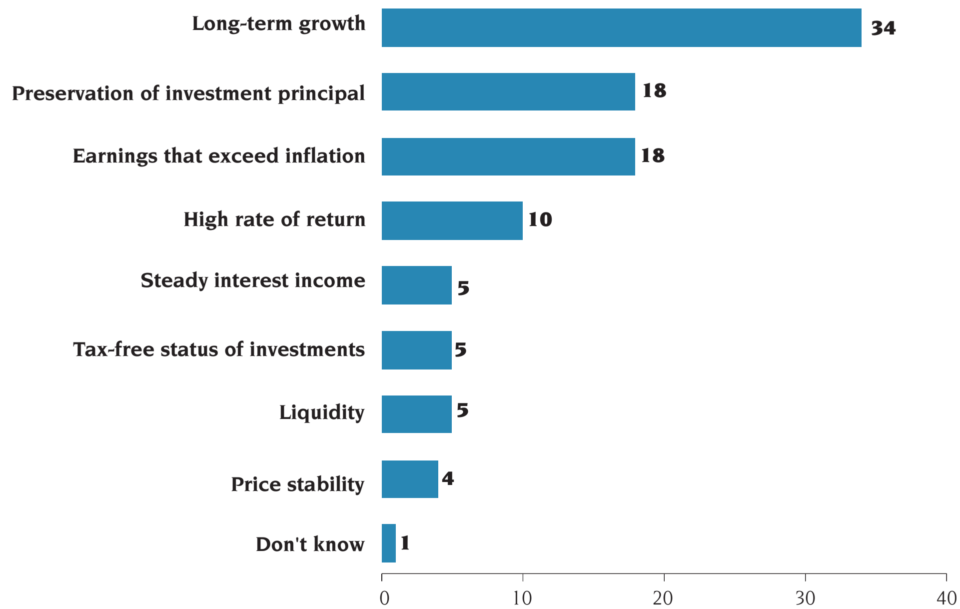
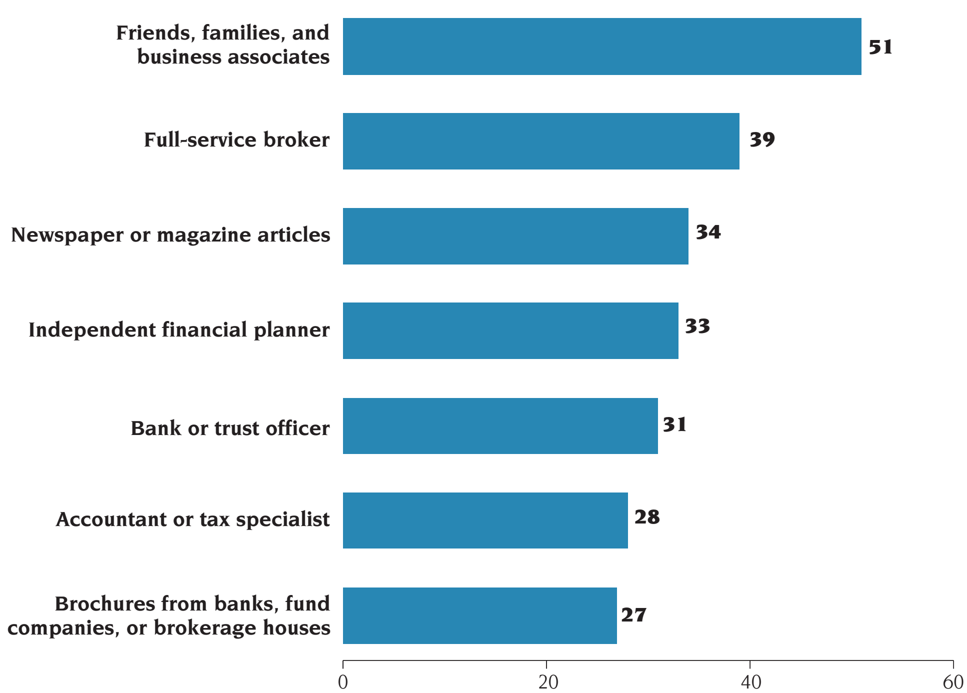


FIGURE 35

Key Sources Conservative Disinterested Shareholders Contact for Investment Information*

(percent of respondents)



**Multiple responses included*

Conservative Directed Shareholders

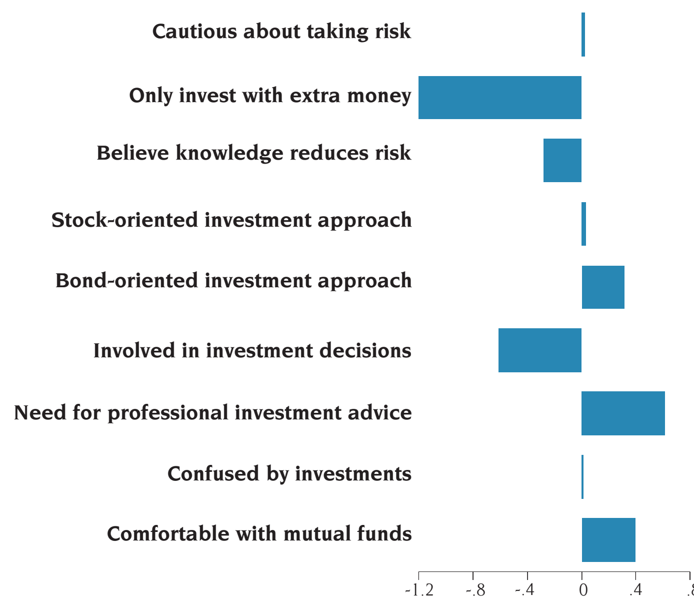
Overview of Conservative Directed Shareholders

Conservative Directed Shareholders have a strong need for professional investment advice and are not very involved in making their investment decisions. More bond-oriented than stock-oriented in their investment approach, Conservative Directed Shareholders are somewhat cautious about taking financial risk. However, they do not invest only with extra money they can afford to lose. Conservative Directed Shareholders do not believe that being more knowledgeable about a particular financial product reduces its investment risk. They are not overly confused by investments and are comfortable with mutual funds. Not surprisingly, they primarily purchase mutual funds from the sales force channel and are most apt to turn to a full-service broker for investment information. Conservative Directed Shareholders have the greatest household financial assets of all segments and are in their early fifties.

FIGURE 33

Underlying Risk and Investment Dimensions of Conservative Disinterested Shareholders

(mean factor scores)



Conservative Directed Shareholders comprise 14 percent of the shareholder population. The largest proportion of this segment, 49 percent, say they are willing to take average financial risk in the hope of obtaining average financial gain, and 30 percent say they are unwilling to take any financial risk. Similar to Daring Independent Shareholders, they say they do not invest only with money they can afford to lose. When compared with other segments, Conservative Directed Shareholders associate less risk with the terms “maximum-return” and “high-yield.”

Conservative Directed Shareholders generally consult others for financial advice. In fact, many indicate that a broker recommended some of their best investments. Conservative Directed Shareholders do not enjoy managing their finances, a characteristic they share with Conservative Disinterested Shareholders.

Altogether, Conservative Directed Shareholders and other members of their households own a median of three mutual funds. Similar to the Daring Independent, Daring Directed, and Conservative Disinterested Shareholders, two thirds of Conservative Directed Shareholders own stock funds. Between four and five out of ten own money market funds, balanced funds, and bond funds. In fact, more Conservative Directed Shareholders own bond funds than does any other shareholder segment. Because Conservative Directed Shareholders are dependent on financial advisers, 82 percent of Conservative Directed Shareholders own sales force-distributed funds, and only 34 percent own direct-marketed funds.

In the Conservative Directed category, shareholders own an average of three types of nonfund investments per household. Similar to most other shareholder segments, 63 percent of Conservative Directed Shareholders own individual stocks. Roughly three in ten own certificates of deposit and fixed annuities, products that are appropriate to their risk-averse disposition. Nevertheless, 29 percent own investment real estate. Perhaps this group equates the tangibility of real estate with investment security.

Aside from full-service brokers, Conservative Directed Shareholders are most apt to consult friends, family, business associates, and independent financial planners for investment information. This group rarely undertakes its own financial analysis through reading magazines, newspapers, or newsletters for financial information.

Women make up 60 percent of Conservative Directed Shareholders. This group has the largest investment portfolio of any segment, holding household financial assets with a median value of $115,000. Three in ten say that their portfolio's performance has exceeded their expectations, the largest proportion of any shareholder segment.

FIGURE 37

Conservative Directed Shareholders' Primary Investment Objective

(percent of respondents)

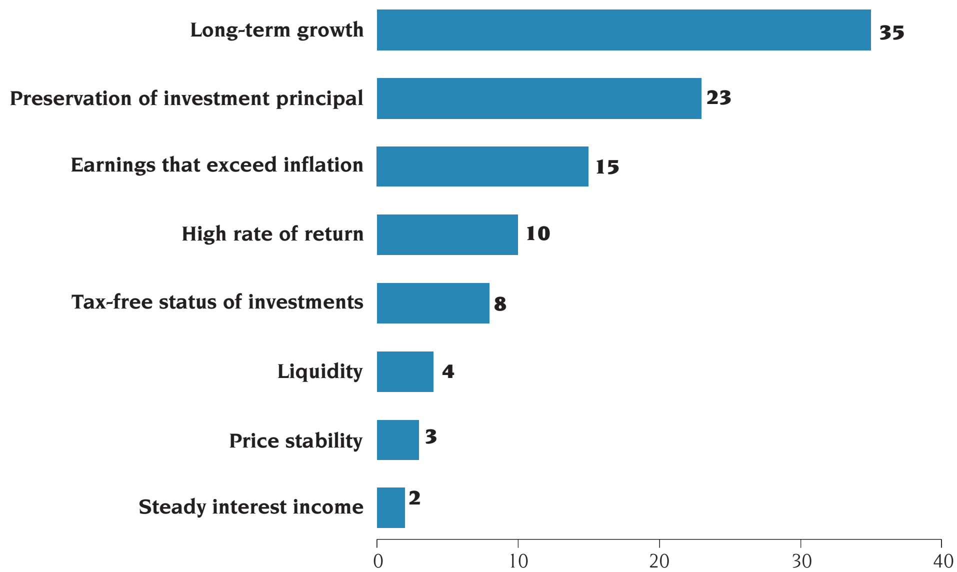
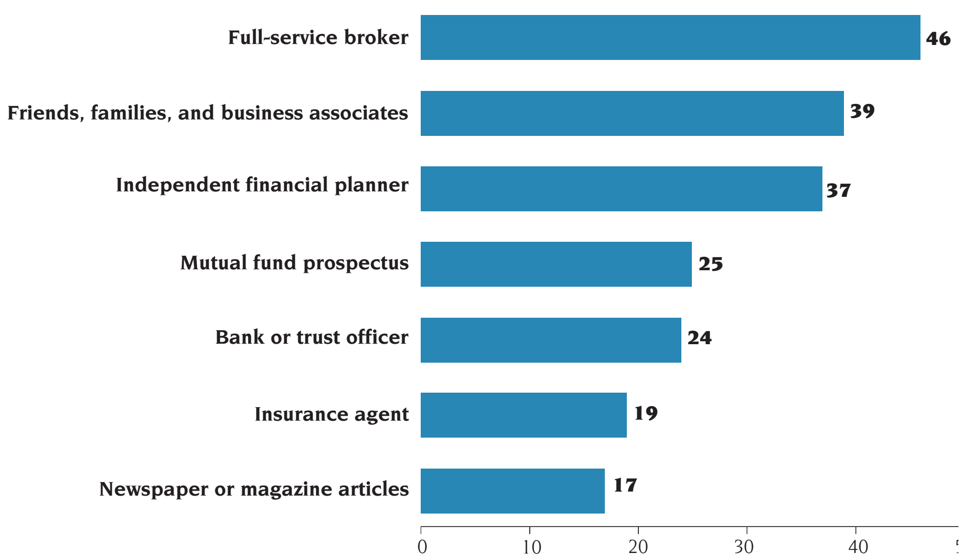


FIGURE 38

Key Sources Conservative Directed Shareholders Contact for Investment Information*

(percent of respondents)



**Multiple responses included*

Apprehensive Directed Shareholders

Overview of Apprehensive Directed Shareholders

Apprehensive Directed Shareholders are very cautious about taking financial risk. They say they invest only with money they can afford to lose. Apprehensive Directed Shareholders say they think the more knowledge an investor has about a particular investment, the less risky that investment becomes. This segment has a strong need for professional investment advice. Apprehensive Directed Shareholders are comfortable with mutual funds and, including other members of their households, typically own three. Most Apprehensive Directed Shareholders purchased their fund shares from the sales force channel. Predictably, this group often turns to a full-service broker for financial information. More than half of all Apprehensive Directed Shareholders are retired, making this group the oldest of the six segments.

FIGURE 39

Underlying Risk and Investment DImensions of Apprehensive Directed Shareholders

(mean factor scores)

Apprehensive Directed Shareholders comprise 13 percent of the shareholder population. They are profoundly risk-averse. In fact, 38 percent say they are unwilling to take any kind of financial risk. More than any other segment, Apprehensive Directed Shareholders believe that purchasing investments they consider extremely risky is analogous to gambling. The members of this segment are also the most likely to say they prefer to play it safe and avoid any investments they deem risky. When compared with other segments, this group is somewhat more likely to associate the phrase “short-term” with risk.

As their name suggests, Apprehensive Directed Shareholders are adviser-dependent. Most indicate that some of their best investments were recommended by a broker. More than any other segment, Apprehensive Directed Shareholders prefer to let their broker decide the best investment risk level for them. Primarily concerned with preserving their principal, Apprehensive Directed Shareholders are not especially worried about whether their investments keep pace with inflation. They say that a long-term investment strategy is best, but also say that short-term fluctuations concern them. Not surprisingly, Apprehensive Directed Shareholders do not enjoy managing their finances and do not watch their investments very closely.

Apprehensive Directed Shareholders own a median of three mutual funds per household. Exhibiting their risk-averse nature, 45 percent of Apprehensive Directed Shareholders own money market funds and just 42 percent own stock funds. Thirty-eight percent of Apprehensive Directed Shareholders own balanced funds, and 33 percent own bond funds. Seventy percent of Apprehensive Directed Shareholders own sales force-distributed funds. Just 27 percent own direct-marketed funds.

Apprehensive Directed Shareholders own an average of 4.4 types of nonfund investments per household. More than half own individual stocks and certificates of deposit. Illustrating their aversion to risk, Apprehensive Directed Shareholders are one of the shareholder segments least likely to own investment real estate or options.

When seeking investment information, Apprehensive Directed Shareholders will generally turn to a person, primarily a full-service broker, rather than to published information. Four in ten say they have obtained financial information from a full-service broker, and roughly three in ten say they have received information from friends, family, business associates, independent financial planners, and bank officers.

Apprehensive Directed Shareholders reinforce the concept that individuals become more financially conservative as they approach retirement. Their median age is 60 years, making them the oldest segment. Retirees comprise 56 percent of this group. Women make up 60 percent of Apprehensive Directed Shareholders. Nearly two in ten members of this segment are widowed.

FIGURE 40

Apprehensive Directed Shareholders' Primary Investment Objective

(percent of respondents)

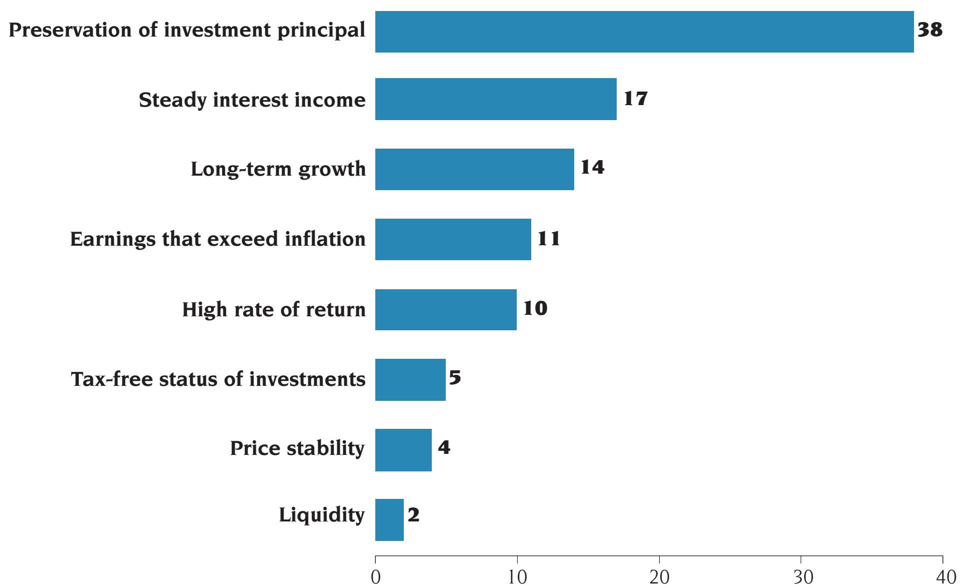
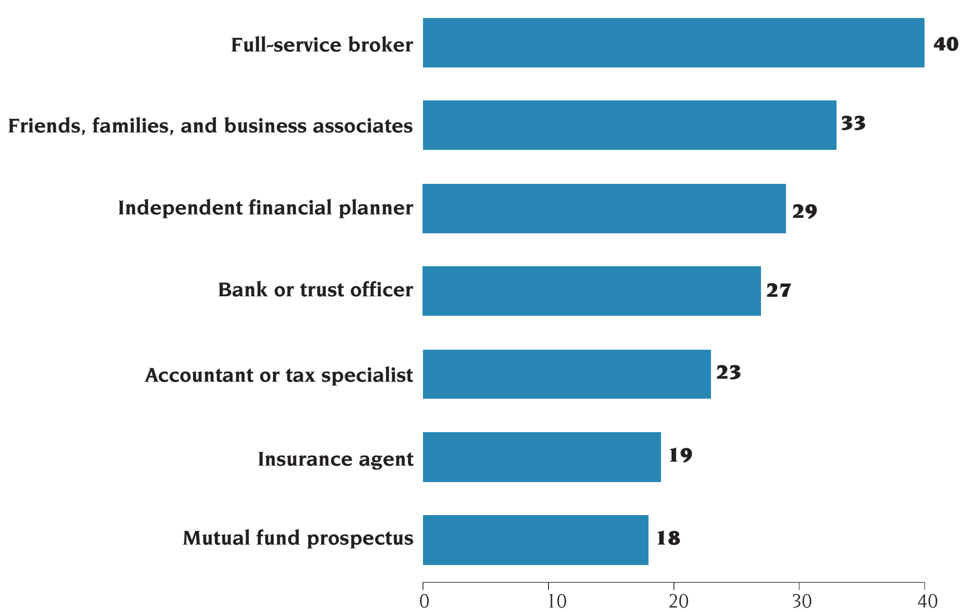


FIGURE 41

Key Sources Apprehensive Directed Shareholders Contact for Investment Information*

(percent of respondents)



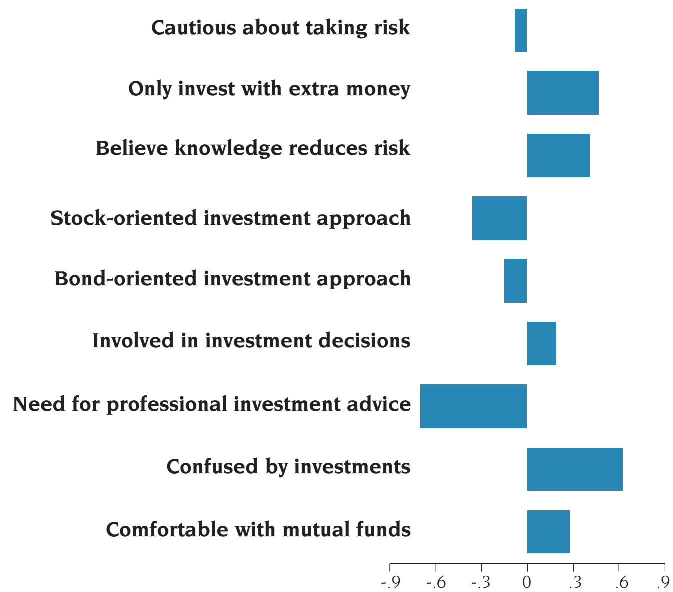
**Multiple responses included*

Apprehensive Independent Shareholders

Overview of Apprehensive Independent Shareholders

Neither stock- nor bond-oriented in their investment approach, Apprehensive Independent Shareholders are fairly cautious about taking financial risk. They say they invest only with extra money they can afford to lose. They believe that more knowledge of an investment reduces its perceived risk. Although Apprehensive Independent Shareholders are confused by investments, they do not seek professional investment advice. They say they are comfortable with mutual funds, but are the shareholder segment least likely to own them. Apprehensive Independent Shareholders are also the least affluent of the six segments. The best way to reach this segment may be through the bank channel because Apprehensive Independent Shareholders are more apt to rely on bank officers for investment information than they are any other financial professional.

FIGURE 42
Underlying Risk and Investment DImensions of Apprehensive Independent Shareholders
(mean factor scores)



Apprehensive Independent Shareholders account for 14 percent of the shareholder population. More than 20 percent of Apprehensive Independent Shareholders say they are more willing to take at least above-average risk to achieve above-average gain. At the same time, however, more than one third of Apprehensive Independent Shareholders say they are unwilling to take any risk.

The term “blue-chip” implies more risk to Apprehensive Independent Shareholders than it does to other segments.

Apprehensive Directed and Apprehensive Independent Shareholders view investment risk similarly. Both believe it is best to play it safe and avoid all investments they regard as risky. What primarily distinguishes Apprehensive Independent Shareholders from Apprehensive Directed Shareholders is their attitude about investing. More so than Apprehensive Directed Shareholders, Apprehensive Independent Shareholders feel inundated by the investment alternatives available to them, and many think that financial products are too complicated to understand. When compared with other segments, however, Apprehensive Independent Shareholders are the least likely to turn to brokers for investment assistance. In fact, Apprehensive Independent Shareholders are the segment least apt to say that a broker has recommended some of their best investments. More than half, however, indicate that friends, family, and business associates are key sources of investment information.

Apprehensive Independent Shareholders own a median of two mutual funds per household. The largest proportion, 55 percent, own money market funds. Along with Apprehensive Directed Shareholders, Apprehensive Independent Shareholders are far less likely to own stock mutual funds than are shareholders in other segments. In fact, only 40 percent of Apprehensive Independent Shareholders own stock funds, 28 percent own bond funds, and 21 percent own balanced funds. Apprehensive

Independent Shareholders are most apt to be customers of the sales force channel, although a comparatively large proportion also own direct-marketed funds.

Altogether, Apprehensive Independent Shareholders and other members of their households own an average of 3.7 types of nonfund investments, the least of all segments. Almost half own certificates of deposit. Only 30 percent own individual stocks, the smallest proportion of all segments. A quarter own investment real estate.

Other than through family, friends, and business associates, it appears that the best way to reach Apprehensive Independent Shareholders is through the bank channel. In fact, when compared with other segments, this group is the most likely to turn to bank and trust officers for investment information.

Apprehensive Independent Shareholders have a median household income of $48,200 and median household financial assets of $66,200. They are one of the least affluent segments. Many are retired and most do not have a college degree. This group's relatively low wealth and limited education may explain their reluctance to use financial advisers. Not surprisingly, Apprehensive Independent Shareholders are most likely to indicate that their investment portfolio's performance has not met expectations.

FIGURE 43

Apprehensive Independent Shareholders' Primary Investment Objective

(percent of respondents)

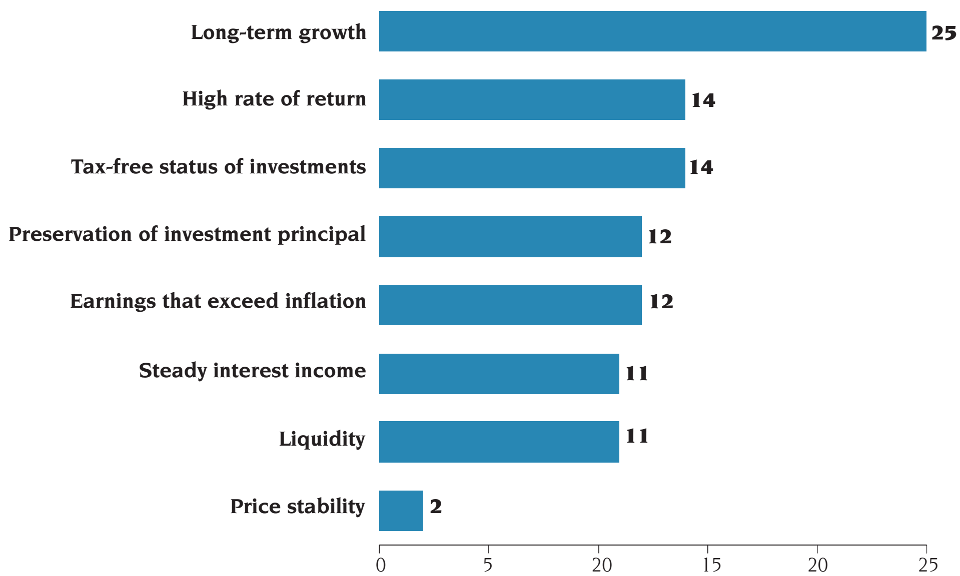
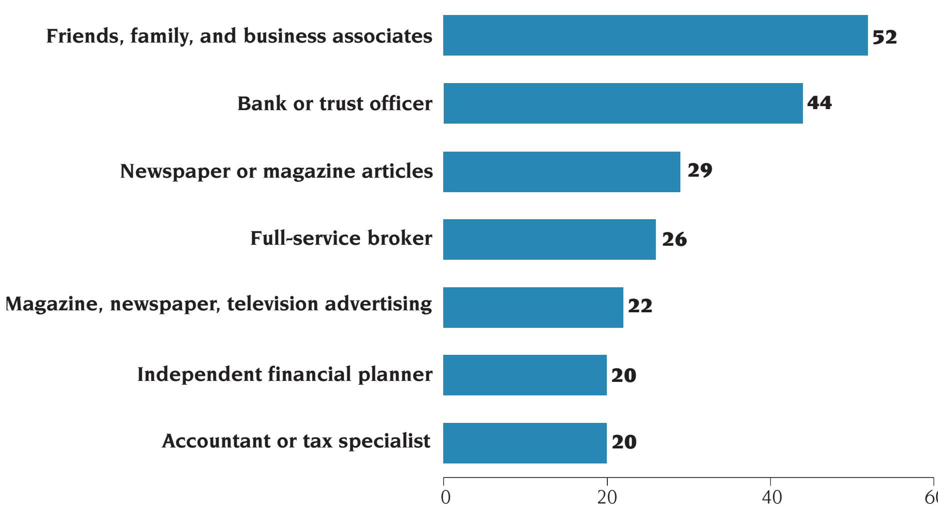


FIGURE 44

Key Sources Apprehensive Independent Shareholders Contact for Investment Information*

(percent of respondents)



**Multiple responses included*

FIGURE 45

Investment Profile of Shareholder Segments

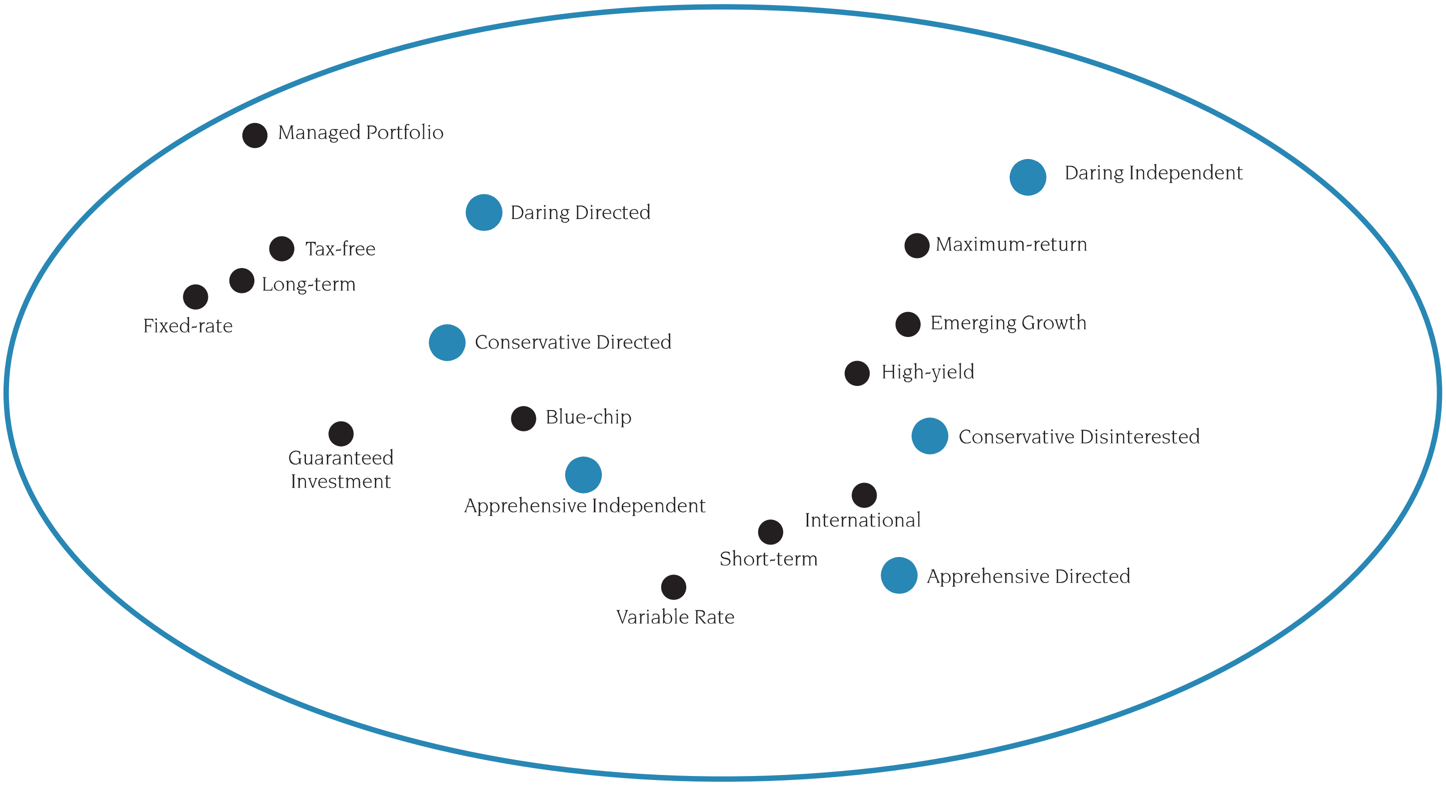
	Daring Independent Shareholders	Daring Directed Shareholders	Conservative Disinterested Shareholders	Conservative DIrected Shareholders	Apprehensive Directed Shareholders	Apprehensive Independent Shareholders
Median number of mutual funds owned per household*	2.0	3.0	2.0	3.0	3.0	2.0
Average number of nonfund investment types owned per household*	4.5	5.1	4.5	4.5	4.4	3.7
Percent of Respondent Households						
Own:**						
Stock funds	65%	69%	66%	66%	42%	40%
Money market funds	42	36	59	49	45	55
Balanced funds	44	35	28	45	38	21
Bond funds	22	28	29	44	33	28
Individual stocks	63	77	65	63	52	30
Certificates of deposit	43	46	36	31	53	47
Fixed annuity	22	31	16	32	26	21
Individual stocks or stock index options	5	30	11	10	3	0
Investment real estate	38	14	26	29	19	25
Have:**						
Sales force-distributed funds	52	82	58	82	70	55
Direct-marketed funds	57	22	44	34	27	39
Investment portfolio's performance exceeded expectations	12	27	16	30	23	7

**Individual stocks and certificates of deposit are examples of nonfund investment types*

***Multiple responses included*

FIGURE 46

Shareholder Segments' Association of Risk with Selected Investment Terms



The closer a segment is to any given investment term, the greater the association of that segment with that investment term. For instance, Conservative Disinterested Shareholders *associate risk with "high-yield" and "international"* Daring Independent Shareholders *associate "maximum-return" with risk.*

See page 54 in Appendix A, Research Methodology, *for guidelines on how to interpret this map.*

See Figure 54 on page 58 in Appendix B, Detailed Tabulations, *for shareholders' mean scores on these items.*

FIGURE 47

Demographic Profile of Shareholder Segments*

	Daring Independent Shareholders	Daring Directed Shareholders	Conservative Disinterested Shareholders	Conservative Directed Shareholders	Apprehensive Directed Shareholders	Apprehensive Independent Shareholders
Median age	46	49	45	51	60	54
Median household income	$64,400	$70,200	$66,000	$55,400	$50,300	$48,200
Average household financial assets**	$62,300	$100,600	$68,100	$115,100	$70,400	$66,200
Percent of Respondents						
Male	68%	52%	43%	40%	40%	52%
Married	85	83	82	67	67	76
Widowed	4	2	8	9	17	12
Employed full- or part-time	75	75	75	68	51	50
Retired from lifetime occupation	22	30	20	32	56	45
Spouse employed***	68	57	80	70	68	70
Four-year college degree or more	65	54	66	40	44	41
Graduate degree	20	16	34	19	18	18
Primary financial goal:						
Saving for retirement	44	31	30	31	25	27
Preserving accumulated assets	13	19	21	19	30	22
Willing to take:						
Substantial risk for substantial gain	3	9	0	5	4	2
Above-average risk for above-average gain	46	35	33	17	7	19
Average risk for average gain	42	44	53	49	51	45
Not willing to take risk	6	12	14	30	38	35

**Respondents were either the household's primary or cofinancial decisionmaker.*
***Excluding real estate*
****Percent of married respondents*

Chapter 5

A Comparison With Nonshareholders

It ain't by princerples nor men

My preudunt course is steadied—

I scent wich pays the best, an' then

Go into it baldheaded.

James Russell Lowell

Chapter 5. A Comparison with Nonshareholders

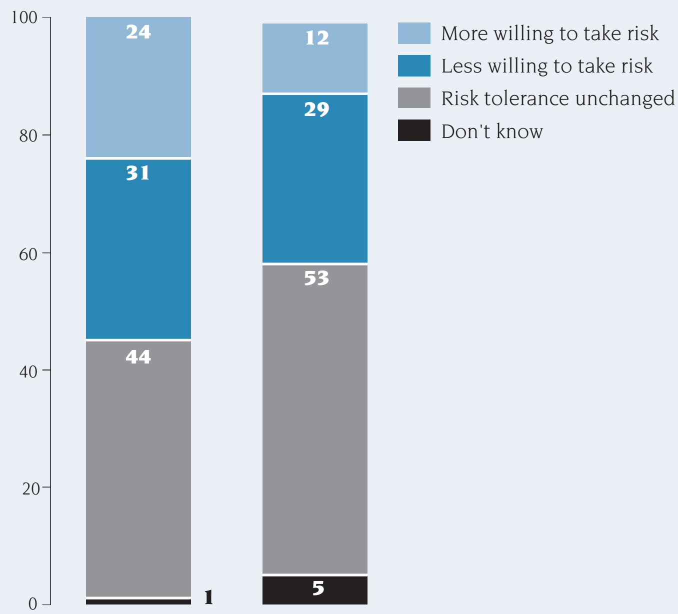
Chapter Summary

In order to put mutual fund shareholders' perceptions of risk into perspective, their responses to several risk-related questions were compared with nonshareholders' responses. This comparison reveals that mutual fund shareholders are generally more willing to take financial risk and are more apt to have increased their willingness to take risk from the time of their first investment. While the two groups have very different attitudes about investment risk, the level of risk they associate with investment terms is comparable, as is the level of risk and return they associate with specific investment products. These findings indicate that fund owners and nonowners generally have the same perceptions about the words frequently used to describe financial concepts so that written communications designed for shareholders also may be appropriate for nonshareholders. The findings also indicate that high expectations about returns from fixed-income products is not a perception limited to mutual fund owners, but is a widely held opinion among investors in general.

FIGURE 48

Comparison of Shareholders' and Nonshareholders' Current Risk Tolerance with Risk Tolerance at Time of First Investment

(percent of respondents)



Self-Assessment of Risk Tolerance

Mutual fund shareholders are more willing to take a financial risk than nonshareholders. When both groups were asked to describe how much risk they are usually willing to take when making an investment, 31 percent of nonshareholders said they are unwilling to take any financial risk, compared with 21 percent of shareholders. In contrast, 18 percent of nonshareholders indicated that they are willing to take above-average risk, compared with 28 percent of shareholders. (See Figure 5 in the Executive Summary, page 5.)

Moreover, shareholders are more likely than nonshareholders to say that their willingness to take financial risk has increased from the time of their first investment. In fact, twice as many shareholders as nonshareholders describe themselves as more willing to take on risk. Nearly half the members in both groups, however, maintain that their tolerance for risk has not changed.

Perception of Risk

Shareholders' and nonshareholders' attitudes toward financial risk are generally similar. However, some differences are worth noting. For example, shareholders are significantly more likely than nonshareholders to believe that a diversified investment portfolio reduces risk. Shareholders are also less likely to say they prefer to avoid all investments they perceive as risky and invest only with money they can afford to lose. They are also less likely to equate purchasing an investment they consider extremely risky with gambling. Perhaps one reason for the divergence in shareholders' and nonshareholders' investment outlook is that more nonshareholders than shareholders say the need to liquidate quickly prohibits them from purchasing riskier investments.

FIGURE 49

Comparison of Shareholders' and Nonshareholders' Attitudes About Financial Risk

(mean score)*

	Shareholders	Nonshareholders
A diversified investment portfolio reduces risk.	7.8	6.9
The older people get, the less willing they are to take investment risk.	7.6	7.4
An investment that involves a great deal of risk isn't an investment, it's gambling.	7.5	8.0
The higher an investment's yield or rate of return, the greater is its associated risk.	7.5	7.3
My approach is to be cautious and avoid all risky investments.	6.4	7.3
I only invest with extra money that I can afford to lose.	5.9	6.8
The more money one has, the more investment risk one can take.	5.7	5.7
The more familiar an investment, the less risky it is.	5.5	5.9
The need to liquidate an investment prohibits me from considering riskier products.	5.0	6.0
Having a broker or financial planner make investment decisions is riskier than making them yourself.	4.7	4.9
My broker decides the best investment risk level for me.	3.7	3.3

**Mean score, with ten equaling strongly agree and zero equaling do not agree*

Investment Terms and Risk

With just a few exceptions, shareholders and nonshareholders also do not differ in the degree of risk they associate with a list of 13 investment terms. As Figure 50 shows, when compared with nonshareholders, shareholders associate slightly more risk with the terms "high-yield," "maximum-return," and "emerging growth." These findings indicate that fund owners and nonowners generally have the same perceptions about the words frequently used to describe financial concepts.

FIGURE 50

Comparison of the Level of Risk Associated with Investment Terms by Shareholders and Nonshareholders

(mean score)*

	Shareholders	Nonshareholders
High-yield	7.2	6.9
Emerging growth	6.9	6.4
Maximum-return	6.7	6.2
International	6.6	6.9
Variable rate	6.3	6.4
Short-term	5.5	5.5
Blue-chip	4.9	5.0
Managed portfolio	4.5	4.6
Balanced	4.3	4.3
Long-term	4.2	4.3
Tax-free	3.7	3.8
Fixed-rate	3.5	3.5
Guaranteed investment	3.2	3.1

**Mean score, with ten equaling great deal of risk and zero equaling no risk*

Views on Product Risk and Return

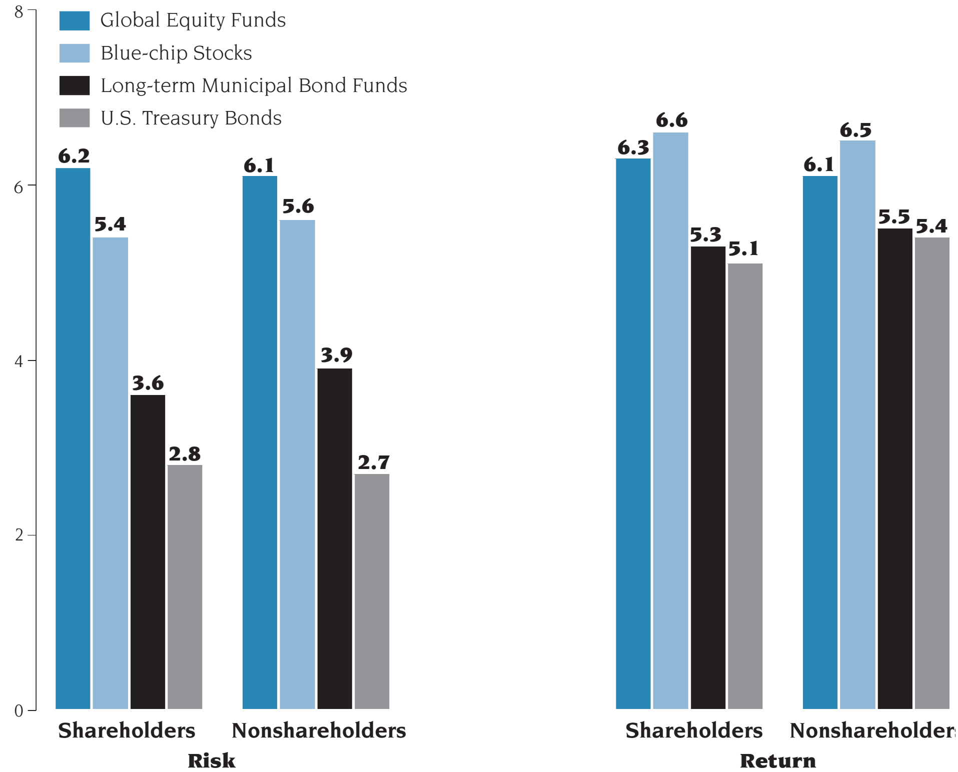
Shareholders and nonshareholders hold similar views on the perceived risk and expected return of global equity funds, blue-chip stocks, long-term municipal bond funds, and U.S. Treasury bonds. For example, on a scale of zero to ten, with a score of ten equaling very risky, global equity funds garnered a mean score of 6.2 from shareholders and 6.1 from nonshareholders. Likewise, on a scale from zero to ten, with a score of ten equaling very high return, global equity funds received a mean score of 6.3 from shareholders and a score of 6.1 from nonshareholders.

Shareholders and nonshareholders alike associate less risk with the two fixed-income products used in the example, but identify them with relatively high potential returns. This finding reveals that the unrealistically high expectations about the returns of fixed-income investments is not a perception limited to mutual fund owners but is a widely held opinion among individual investors.

FIGURE 51

Comparison of Shareholders' and Nonshareholders' Views on Product Risk and Return

(mean score)*



Mean score, with ten equaling very risky or very high return and zero equaling not very risky or very low return

Appendix A

Research Methodology

Research Design

The data presented in this report are the result of an extensive survey undertaken by the Response Analysis Corporation, under the direction of the Investment Company Institute's Research Department. The research program consisted of two stages.

In Stage One, Response Analysis conducted focus group interviews with mutual fund owners and nonowners. The objectives were to explore and understand fund owners' and nonfund owners' perception of risk, the language they use to describe risk, their attitudes about risk, what factors influence their willingness to take financial risk, and their knowledge of the various components of risk.

Stage Two comprised the quantitative phase of the research program. A comprehensive questionnaire was constructed based on the focus group findings and input from Institute staff, Research Committee members, and Response Analysis staff. Experienced and trained interviewers from the Response Analysis team conducted in-person interviews in the summer of 1992. Each interview took about one hour and was arranged by appointment. A total of 604 interviews were completed—311 with fund owners and 293 with nonfund owners. To ensure the likelihood that nonfund owners had investments, this group was limited to households with income levels of $50,000 or more, or savings and investments totaling $50,000 or more. Regional quotas were established to ensure an appropriate distribution of the owner and nonowner samples. The data were weighted by region to correct for differences in cooperation and to project it to the universe of mutual fund owners and nonowners.

Survey respondents were the household's primary or codecisionmaker for saving and investments. Among the fund-owning households, 50 percent had joint financial decisionmakers, 30 percent had a male decisionmaker, and 20 percent had a female decisionmaker. The pattern was similar among the nonfund-owning households.

The Risk Score

A score was developed to group the shareholders who participated in the survey according to their tolerance for financial risk. The score is based on their level of agreement with four statements about financial risk, as well as their self-assessment of their willingness to take financial risk. An analysis of the survey results identified these items as indicators of shareholders' risk tolerance.

The four statements with which respondents were asked to agree or disagree are:

- The risk involved in playing the stock market is fun and exciting.
- I only invest with extra money I can afford to lose.
- An investment that involves a great deal of risk isn't really an investment, it's gambling.

- My approach is to be cautious and avoid all "risky" investments.

Respondents used a zero to ten scale to rate their level of agreement with each of these statements. For their first statement, a rating of ten signified high risk tolerance, and zero signified low risk tolerance. For the remaining three statements, the scale was reversed—a ten signified low risk tolerance and a zero signified high risk tolerance.

Respondents' self-assessment of their willingness to take financial risk consisted of selecting one of the following four statements to describe themselves:

- I am willing to take a substantial financial risk in the hope of making a substantial monetary gain.
- I am willing to take above-average financial risk in the hope of making an above-average monetary gain.
- I am willing to take average financial risk in the hope of making an average monetary gain.
- I am not willing to take any financial risk.

Each of these statements was assigned a value on a ten-point scale. Willingness to take substantial risk was given a value of ten, willingness to take above-average risk was assigned a value of seven, willingness to take average risk was given a value of four, and unwillingness to take any financial risk was assigned a value of one.

A total score was then calculated for each responding shareholder. Possible scores ranged from a low of one to a high of 50. Shareholders were categorized low, moderate, and high risk-tolerant according to their score. Altogether, 34 percent of responding shareholders fell into the low risk-tolerant group, 36 percent fell into the moderate risk-tolerant group, and 30 percent fell into the high risk-tolerant group.

Factor Analysis

Factor analysis is a data reduction technique that was used in this study. Because practical problems arise when a large number of variables are analyzed, data reduction techniques are often applied to remove the redundancy from a set of correlated variables and represent them with a smaller set of "derived" variables, or factors. Hence, factor analysis can be thought of as removing duplicative information from a set of variables through the grouping of similar variables.

Factor analysis can be applied to a variety of data analysis situations. In this study, factor analysis was used to identify the factors underlying a large set of variables—the 41 attitude statements on financial risk and investing. It reduced the 41 attitude statements to nine underlying factors, or dimensions.

The factor analysis procedure comprises three key stages. The first is the creation of the original data matrix—the ratings of each respondent to the 41 attitude statements. The second key stage is the creation of the correlation matrix, which is the systematic arrangement of the correlation coefficients that exist between each combination of two variables. The third stage is the creation of a factor matrix.

The cell entries of the factor matrix are called factor loadings and may vary in value from -1.00 to +1.00. Factor loadings represent the degree to which each of the variables correlates with each of the factors. Variables with high loadings on a factor (either + or -) provide the meaning and interpretation for that factor. Variables with a low or zero loading on a particular factor do not contribute to the meaning of that factor. Factors are typically given names that reflect their high loading variables.

Each respondent has a value for each of the factors. These values are called factor scores. A factor score is a summation of a respondent's score on each of the attitude statements that comprise a factor multiplied by its factor loading. In this study, mean factor scores were derived for the six shareholder segments discussed in Chapter 4. The mean factor scores identify the degree to which each factor describes each segment relative to the other segments. Because factors are independent variables, mean factor scores do not indicate that one particular dimension is any more or less important than another in describing a segment.

Perceptual Mapping

Perceptual mapping is a pictorial representation of data obtained from a multidimensional scaling procedure. Like factor analysis, perceptual mapping is also a data reduction technique. Perceptual maps are designed to provide an overall impression of the data. Individual relationships and measures in any map must be confirmed by cross-tabulations.

Some general rules for interpreting the maps in this report are described below. When applying the guidelines to Figure 13 (page 12), the "segments" are the four investment products, for example, global equity funds and blue-chip stocks; the "terms" are the investment objectives, such as liquidity and long-term growth. When applying the guidelines to Figure 46 (page 45), the "segments" are the six shareholder groups, for example, Daring Independent Shareholders and Daring Directed Shareholders; the "terms" are the investment terms, such as maximum-return and managed portfolio.

- The closer a segment is to the center of the map, the less distinct it tends to be from other groups. Conversely, the farther away the group is from the center, the stronger its association (or dissociation) with another item on the map.

- Items close to the center of the map tend to be "shared" by most segments on the map. Items close to the edges of the map tend to be associated more strongly with some segments than others—depending on the proximity to those groups.
- Segments close to each other tend to have similar associations.
- The closer a segment is to an item, the more closely it is associated with that item.

Sampling Error

As sample size increases, the level of potential sampling error generally becomes smaller. Figure 52 shows the approximate minimum difference required for statistical significance at the 95 percent confidence level of observed percentages for various sample sizes.

FIGURE 52

Statistical Reliability for Determining Accuracy of Observed Percentages Within a Sample

	Observed Percentages				
	10/90	30/70	50/50	70/30	90/10
	Sampling Errors at the 95 Percent Confidence Level				
Sample Size					
50	±8.2	±12.7	±13.8	±12.7	±8.2
100	±5.9	±8.9	±9.6	±8.9	±5.9
150	±4.8	±7.3	±8.0	±7.3	±4.8

In a hypothetical case, if the observed percentage for a "yes" answer was 10 percent in a sample of 100, then the reader can be 95 percent confident in inferring that the sample reflects the total population with a sampling error of + or - 5.9 percent

Appendix B

Detailed Tabulations

FIGURE 53

Mean Scores for Shareholders' Association of Selected Investments with Investment Objectives*

	Long-term Municipal Bond Funds	U.S. Treasury Bonds	Blue-chip Stocks	Global Equity Funds
Tax-free status	7.5	6.1	3.5	3.4
Preservation of investment principal	7.2	8.3	5.3	4.9
Price stability	7.1	7.7	5.3	4.8
Long-term growth	6.4	6.7	6.7	6.2
Steady interest income	6.5	6.3	5.9	5.2
Earnings that exceed inflation	5.6	5.5	6.7	6.2
High rate of return	5.6	5.5	6.8	6.3
Liquidity	4.0	4.8	6.6	5.7

**Mean score, with ten equaling completely meets objective and zero equaling does not meet objective*

FIGURE 54

Means Scores for Shareholder Segments' Association of Risk with Selected Investment Terms*

	All Shareholders	Daring Independent Shareholders	Daring Directed Shareholders	Conservative Disinterested Shareholders	Conservative DIrected Shareholders	Apprehensive Directed Shareholders	Apprehensive Independent Shareholders
High-yield	7.2	7.6	7.2	7.3	6.7	7.9	6.8
Emerging growth	6.9	7.4	6.7	7.0	6.5	6.7	7.1
Maximum return	6.7	7.9	6.5	6.8	5.9	6.9	6.1
International	6.6	6.6	6.3	6.6	6.4	6.7	7.1
Variable rate	6.3	6.1	6.2	6.4	6.1	6.7	6.1
Short-term	5.5	5.5	5.4	5.5	5.1	5.5	5.6
Blue-chip	4.9	4.7	5.2	5.0	4.1	5.0	5.5
Managed portfolio	4.5	4.3	4.9	4.5	4.4	4.2	4.8
Balanced	4.3	3.9	4.6	4.3	4.3	3.9	4.7
Long-term	4.2	3.6	4.6	4.2	4.3	3.8	4.6
Tax-free	3.7	3.4	3.9	4.3	3.4	3.2	3.4
Fixed-rate	3.5	3.2	4.0	3.2	3.3	3.5	4.0
Guaranteed investment	3.2	2.8	3.3	3.4	2.8	3.1	3.6

**Mean score, with ten equaling great deal of risk and zero equaling no risk*

FIGURE 55

Level of Agreement with Statements About Risk

(mean score)*

	All Shareholders	Daring Independent Shareholders	Daring Directed Shareholders	Conservative Disinterested Shareholders	Conservative Directed Shareholders	Apprehensive Directed Shareholders	Apprehensive Independent Shareholders
A diversified investment portfolio reduces risk.	7.8	8.3	7.9	7.8	7.8	8.1	7.3
The older people get, the less willing they are to take investment risk.	7.6	7.5	7.6	7.2	7.3	8.4	7.9
An investment that involves a great deal of risk isn't really investing it's gambling.	7.5	6.3	7.6	7.5	6.8	8.6	8.3
The higher an investment's yield or rate of return, the greater its associated risk.	7.5	7.9	6.9	7.3	6.8	8.3	7.9
My approach is to be cautious and avoid all risky investments.	6.4	4.6	6.0	6.0	6.5	8.6	7.4
I only invest with extra money that I can afford to lose.	5.9	2.8	6.4	7.6	1.6	8.1	7.5
The more money one has, the more investment risk one can take.	5.7	4.8	5.7	5.9	4.7	6.2	6.6
The more familiar an investment, the less risky it is.	5.5	4.5	6.0	4.4	5.0	7.6	6.9
The need to liquidate quickly prohibits me from considering riskier products.	5.0	3.4	5.6	5.3	4.0	5.6	5.8
Having a broker or financial planner make investment decisions is riskier than making them yourself.	4.7	5.0	5.2	4.8	3.5	4.7	5.3
My broker decides the best investment risk level for me.	3.7	1.4	4.9	3.7	4.4	6.1	2.5

**Mean score, with ten equaling strongly agree and zero equaling do not agree*

FIGURE 56

Level of Agreement with Statements About Investing

(mean score)*

	All Shareholders	Daring Independent Shareholders	Daring Directed Shareholders	Conservative Disinterested Shareholders	Conservative Directed Shareholders	Apprehensive Directed Shareholders	Apprehensive Independent Shareholders
The best way to make money is to adopt a long-term strategy.	8.2	8.4	8.5	7.9	7.7	8.7	8.1
Mutual fund managers can do a better job of investing than most people can do by themselves.	7.4	7.3	7.2	6.9	7.5	8.5	7.3
I try to make sure that my investments keep pace with inflation.	7.4	8.1	8.3	6.7	7.3	7.2	7.6
I prefer investments with tax advantages.	7.3	5.9	8.2	6.9	7.9	7.6	7.6
Mutual funds provide the widest diversification of any investment vehicle.	7.3	8.0	7.5	6.4	7.5	8.3	7.0
The small investor can still make money in the stock market.	7.2	7.7	7.5	7.0	7.0	7.4	6.9
Mutual funds tend to be less volatile than other investments.	7.0	7.1	6.9	7.0	6.8	8.1	6.4
I am not concerned about short-term fluctuations in my long-term investments.	7.0	8.2	7.1	6.9	6.7	6.0	6.7
For the highest possible return in bonds, look for ones with the highest quality rating.	6.4	5.3	6.6	5.9	6.6	7.5	7.0
I follow my investments closely.	6.4	7.6	7.7	5.7	6.5	6.1	5.8
There are too many investments; it's hard to tell which ones are good.	6.2	4.2	7.2	5.1	6.4	7.0	8.7
I enjoy managing my savings and investments.	5.9	8.1	7.9	4.7	4.2	5.8	6.5
Stock mutual funds generally perform better than the stock market.	5.8	5.3	6.9	5.5	5.6	5.9	6.1
Blue-chip stocks are always good investments.	5.7	5.3	6.8	6.5	5.6	5.4	3.6
For low risk in a bond investment, look for ones with long maturities	5.7	4.9	6.3	5.6	6.5	6.5	5.2
The only safe investments are guaranteed by the federal government	5.3	4.1	6.6	4.6	5.6	6.3	5.5

FIGURE 56 (continued)

Level of Agreement with Statements About Investing

(mean score)*

	All Shareholders	Daring Independent Shareholders	Daring Directed Shareholders	Conservative Disinterested Shareholders	Conservative Directed Shareholders	Apprehensive Directed Shareholders	Apprehensive Independent Shareholders
Some of my best investments were recommended to me by my broker or financial planner.	5.2	2.5	7.4	5.0	7.9	8.2	1.3
Most investments are too complicated to understand.	5.1	3.3	5.3	4.9	5.6	5.9	6.1
I can make my own investment decisions without advice from others.	4.6	5.8	5.7	4.3	2.9	3.9	5.2
Over time, stocks have not done as well as putting money in a CD and letting it earn interest.	3.6	1.3	5.1	3.4	3.5	4.7	4.4
I know more about investing than most people.	4.5	5.8	5.6	4.6	3.0	3.7	4.3
If I can break even on an investment, I don't feel I've lost money.	3.0	1.6	3.6	3.1	2.9	4.1	3.1
The risk associated with playing the stock market is fun and exciting.	3.9	4.9	4.8	3.6	2.6	3.6	4.2
Today the "smart" money is going into high-yield bonds.	4.8	3.4	5.7	4.6	4.3	6.2	5.1
Bond mutual funds are the best way to get a high rate of return.	4.9	3.0	5.5	4.7	6.0	6.4	4.3
In the long run, individual stocks are the best place for my money.	4.3	4.7	5.3	3.9	4.2	3.8	4.1
Mutual funds tend not to do as well as other types of investments.	3.8	2.5	4.5	4.2	3.7	3.3	4.2
Putting money into mutual funds that invest overseas is less risky than putting money in mutual funds that only invest in the U.S.	3.3	2.2	4.9	3.2	3.7	4.7	1.7
A bond fund can always be sold for the same price for which it was purchased.	3.2	2.1	4.6	3.1	2.5	4.2	3.4
I constantly shift my investments around to get the best return.	2.8	2.5	7.6	2.3	1.7	2.1	1.6

**Mean score, with ten equaling strongly agree and zero equaling do not agree*

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