



FINANCIAL ADVICE AND INVESTOR BELIEFS

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THE BASIC PREMISE

- Many individuals are poorly prepared for important financial decisions about retirement savings and investing
 - Lack of financial literacy, e.g. Lusardi and Mitchell (2009)
 - Behavioral biases, e.g. Bernartzi & Thaler (2007); Odean (2002)
- Financial advisors can play an important role in helping investors improve the quality of their decisions
 - Inform investors about fundamental finance concepts
 - Help formulate and implement investment strategies
 - Give people the confidence to invest in markets



...Finance is Hard?

CHALLENGES: MARKET FOR FINANCIAL ADVICE



- **Supply side:** How do incentives and costs affect the advice investors get?
 - Challenge of educating and “de-biasing” clients in a sales situation
- **Demand side:** How do preconceptions and biases of investors affect the advice that can be given?
 - Are advisors constrained by their client’s preexisting beliefs about the best investment strategies?

SUPPLY SIDE: AUDIT STUDY OF THE MARKET FOR FINANCIAL ADVICE



- How do advisors react to clients with different biases?
 - How good is the quality of advice given
 - Compare biases that either work in the advisor's interest to those that would reduce fees to advisors
- Mullainathan, Noeth and Schoar (2016): Mystery shopping
 - Sent trained auditors as “clients” to get financial advice
 - Sample size of over 450 visits in Boston and NYC areas

SUPPLY SIDE CHALLENGES





TREATMENTS

Treatment 1 – Chasing past returns:

- Auditor was assigned a portfolio that has 30% of the funds invested in sectors with high past returns. The auditor asked the advisor's opinion investing a large fraction of the money in those sectors which had high returns in the past.

Treatment 2 – Company stock:

- Auditor had a portfolio that has 30% of the funds invested in company stock (stocks of the company s/he is assigned to say s/he works at). Auditor will ask the advisor's opinion investing a large fraction of the money in his/her company stock.

Treatment 3 – Index portfolio:

- Auditor had an efficient portfolio invested in index funds. Auditor asked the advisor's opinion about investing in index funds.

Treatment 4 – Cash Treatment (Control Group)

- Mystery shopper was assigned a portfolio of cash and CDs. Auditor asked the advisor for general advice on portfolio investing.

WHAT DO ADVISORS SUGGEST?

VARIABLES	Yes	No	Total
Advisors encourage more of current strategy?	13%	87%	456
Advisors suggest change of current strategy?	67%	33%	456
Recommend Index Funds	10%	90%	456
Recommend Actively Managed Funds	50%	50%	456
Spontaneously mention fees	60%	40%	456
Ask about age	85%	15%	456
Ask about current occupation	82%	18%	456
Ask about annual income	79%	21%	456
Auditor would go back to this advisor with own money	70%	30%	456

VARIABLES	(1) advisor encouraged client to invest more in the existing strategy	(2)	(3)	(4)	(5) advisor discouraged client to invest more in the existing strategy	(6)	(7)	(8)
Investment Amount			≈\$100k	≈\$50k			≈\$100k	≈\$50k
Company Stock PF	-0.165** (0.0807)	-0.185** (0.0780)	-0.216 (0.154)	-0.205* (0.102)	0.110 (0.0908)	0.162 (0.111)	0.0550 (0.179)	0.297** (0.117)
Index Funds PF	-0.284** (0.111)	-0.304** (0.116)	-0.418* (0.210)	-0.300** (0.108)	0.397*** (0.0989)	0.438*** (0.109)	0.476** (0.176)	0.521*** (0.147)
log(Auditor's Age)	0.0965 (0.152)	0.0121 (0.396)	0.991 (0.732)	-0.681 (0.489)	-0.0175 (0.181)	0.380 (0.485)	0.394 (0.481)	1.888** (0.775)
log(Annual Income)	-0.266 (0.228)	-0.249 (0.260)	-0.124 (0.349)	-0.801*** (0.166)	0.358 (0.252)	0.381 (0.262)	0.123 (0.390)	0.751** (0.275)
log(Investment Amount)		0.0190 (0.258)				-0.186 (0.293)		
Marital Status		-0.0354 (0.0355)				0.0866 (0.0924)		
Children		-0.125* (0.0682)				0.135 (0.119)		
Gender		-0.0119 (0.108)				-0.0871 (0.127)		
Observations	204	203	105	99	204	203	105	99
R-squared	0.093	0.116	0.137	0.158	0.107	0.127	0.148	0.165



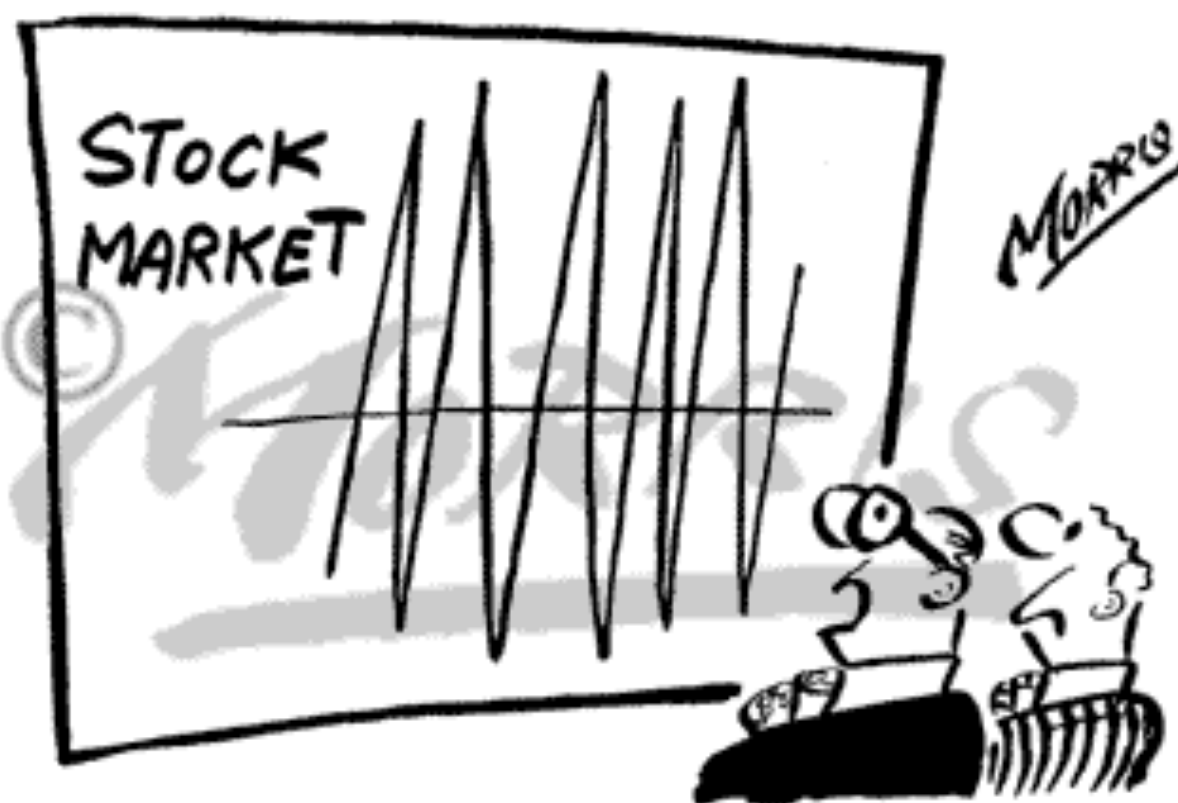
KEY FINDINGS

- Advisors support biases that are in their interest
 - Lean strongly against investing in index funds
 - Lean against investing in own company stock (relative to trend chasing)
- Advisors have strong preferences for actively managed funds over index funds
 - Push active funds even for people who have index portfolio
- Effects are stronger for brokers than fiduciary advisors

DEMAND SIDE: WHAT ADVICE DO CLIENTS UNDERSTAND?



- Are advisors constrained by the priors or financial beliefs of their clients? Need to cater to clients?
 - What perceptions do clients have about investment strategies?
 - Do they understand importance of diversification or minimizing fees?
- How do clients update about the quality of advisors
 - Do they know good advice when they see it?



"Mark my words sir, as your broker it takes a lot more nerve to sit tight and do nothing."

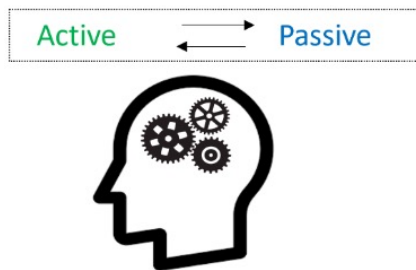
RESEARCH DESIGN: LAB EXPERIMENT

Present participants with financial advisors who present different investment strategies

Work with employers in the Boston and Cambridge areas

Conduct baseline survey to gauge the subject's financial literacy and prior beliefs about investment strategy

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We measure people's priors

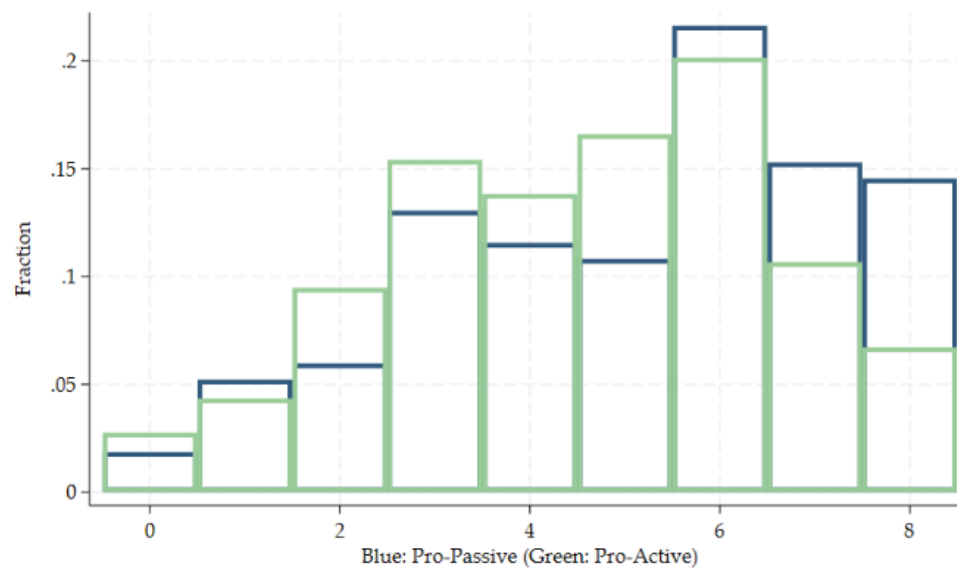
- These priors might be shaped by public discussion of best investment strategies, (social) media, friends etc.

Subjects are shown financial advice videos

- recommending either active or passive strategies; language scripted from typical advice
- not financial literacy training
- designed to be “narratives” including (selected) data and their interpretation (Eliaz and Spiegler 2020; Schwartzstein and Sunderam 2021)



DISTRIBUTION OF KNOWLEDGE SCORE BY BELIEF TYPE



Pro-passive belief correlated with higher financial literacy, but we observe all levels of knowledge scores for both types of priors

IMPLEMENTATION



	Active Video	Passive Video
Introduction	<ul style="list-style-type: none">○ Self-Introduction○ Introduce both strategies	<ul style="list-style-type: none">○ Self-Introduction○ Introduce both strategies
Emphasized Strategy	<ul style="list-style-type: none">○ Stock selection○ Market timing	<ul style="list-style-type: none">○ Diversification○ Fee minimization
Core Narrative	<ul style="list-style-type: none">○ Market research adds value○ Top-performers are actively managed funds.○ Active strategy dominates	<ul style="list-style-type: none">○ No one has a crystal ball○ Index funds on average outperform actively managed funds○ Passive strategy dominates



EXPERIMENTAL DESIGN: 2-BY-2 TREATMENT GROUPS



Prior Belief	Watching	# Subjects
Pro-Passive	Passive Video	120
	Active Video	128
Pro-Active	Passive Video	128
	Active Video	125

- Participants are classified as pro-active or pro-passive based on pre-video survey responses
- Each participant watches a randomly assigned video containing advice advocating for either active or passive strategy

ASSESSMENT OF THE QUALITY OF ADVICE

	(1)	(2)	(3)	(4)
	<i>Agree with Recommendation</i> <i>1(Strongly Disagree) 9(Strongly Agree)</i>			
<i>Contradict</i>	-0.641*** (0.149)			
<i>Passive Video</i>		0.639*** (0.149)		
<i>Pro-Active, Passive Video</i>			-0.252 (0.216)	-0.370* (0.210)
<i>Pro-Passive, Passive Video</i>			0.335 (0.219)	0.262 (0.218)
<i>Pro-Passive, Active Video</i>			-0.610*** (0.219)	-0.573*** (0.213)
<i>Constant</i>	6.765*** (0.098)	6.122*** (0.115)	6.807*** (0.154)	4.751*** (0.928)
Advisor F.E.	Yes	Yes	Yes	Yes
High Literacy × Video Type	No	No	Yes	Yes
Control Variables	No	No	No	Yes
Observations	500	500	500	493
R-squared	0.051	0.051	0.115	0.184

DIFFERENCE BETWEEN HIGH- AND LOW LITERACY PARTICIPANTS

	<i>Agree with Recommendation</i> <i>1(Strongly Disagree) ~ 9(Strongly Agree)</i>	
	High Lit	Low Lit
<i>Pro-Active, Passive Video</i>	-0.177 (0.346)	0.062 (0.231)
<i>Pro-Passive, Passive Video</i>	0.898*** (0.331)	0.320 (0.242)
<i>Pro-Passive, Active Video</i>	-1.075*** (0.371)	-0.231 (0.253)
<i>Constant</i>	6.282*** (0.267)	6.629*** (0.161)
Advisor F.E.	Yes	Yes
Observations	231	269
R-squared	0.171	0.046

Strong opinions about advice quality are expressed by financially sophisticated participants, while those with low literacy evaluate all advice similarly.

ESTIMATES OF BELIEF UPDATING



	(1) Full	(2) Contradict Only	(3) Full	(4) High Lit	(5) Low Lit
<i>Change in Pro-Passive Score</i>					
<i>Video Direction</i>	1.341*** (0.104)	2.356*** (0.144)			
<i>Pro-Active, Passive Video</i>			3.122*** (0.262)	3.178*** (0.376)	3.030*** (0.352)
<i>Pro-Passive, Passive Video</i>			0.553** (0.229)	0.818*** (0.286)	0.566 (0.345)
<i>Pro-Passive, Active Video</i>			-1.587*** (0.278)	-0.574 (0.370)	-2.570*** (0.396)
<i>Constant</i>	0.559*** (0.104)	0.790*** (0.144)	0.021 (0.178)	-0.397* (0.240)	0.275 (0.245)
Advisor F.E.	Yes	Yes	Yes	Yes	Yes
Observations	493	252	493	229	264
R-squared	0.255	0.521	0.415	0.372	0.475

- Dependent variable = Δ Pro-Passive Score from before to after video
- Video Direction = 1 for Passive Video and -1 for Active Video



CONCLUSION

- Large fraction of population recognizes "textbook" advice
 - Diversification and low fee investing is important
 - Rates passive strategies higher
- Participants who have higher financial literacy
 - Rate passive advice higher and rate advisors low who try to convince them otherwise
 - "They know what they know"
- Less financially literate participants can be steered by both narratives. Encouragingly, less financially literate consumers are receptive to advice

THANK YOU