Investment risk tolerance affected by age, economic climate, study shows

January 9 2012

As the U.S. economy continues to lag, many investors remain wary about taking risks with the stock market. Now, researchers at the University of Missouri have concluded that this attitude toward investment risk-taking is influenced by the age of the investor and the economic climate of the time period. Rui Yao, an assistant professor of personal financial planning in the College of Human Environmental Sciences at MU, found that willingness to take financial risks, or "risk tolerance," decreases as investors age.

"Age has a pragmatic relationship with financial risk," Yao said. "Each additional year of life represents a shortened time horizon for recouping market losses. In addition, individuals approaching or in retirement may shift focus from asset accumulation to asset preservation. These individuals may become relatively more concerned about potential loss of money when they are closer to retirement or no longer have a steady source of income."

For her study, Yao analyzed data from the 1989-2007 Survey of Consumer Finances, which is a survey supported by the Federal Reserve Board in cooperation with the Internal Revenue Service. Yao found that risk tolerance also was influenced by the economic climate of the time period. As the economic outlook increased, so did risk tolerance. However, she found that risk tolerance also decreased as the economy slowed. Yao says this is a concerning trend.

"Investors should not let the economic climate affect their risk tolerance," Yao said. "Taking more risks during an economic rise and fewer risks during a downturn amounts to buying high and selling low. That is a very counter-productive strategy."

Yao says it is important for investors and financial planners to understand risk tolerance and how it affects their investments.

"The duty of financial planners is to recommend appropriate investment portfolios based on client financial risk tolerance," Yao said. "A good understanding of their clients' attitude toward risk and how and why such attitudes change is critical. Concern exists that the United States will continue to experience a turbulent economy for some time to come. Unnecessary losses may occur if an individual's investment portfolio mismatches his or her risk tolerance, leading to inappropriate portfolio allocation decisions. Client education on financial risk is important so that a client can align personal investment goals with the ability to tolerate market fluctuations."

This study was published in the *Journal of Socio-Economics*.

Provided by University of Missouri-Columbia

Citation: Investment risk tolerance affected by age, economic climate, study shows (2012, January 9) retrieved 23 April 2024 from https://phys.org/news/2012-01-investment-tolerance-affected-age-economic.html