

Buying High? The House Money Effect on DC Plan Stock Investment

Rui Yao, University of Missouri¹
Shan Lei, University of Missouri²

As more and more employees are eligible for defined contribution (DC) plans as versus defined benefit (DB) plans, they have to shoulder the responsibility to manage their plan assets in order to achieve the desired consumption during retirement. With the well-known projections of the Social Security program and the longevity expectation of individuals, the retirement financial outlook for today's workforce is a concern.

Portfolio allocation affects retirement wealth (Papke, 2004). When making portfolio allocation decisions, investors should focus on factors such as financial goals, risk and return of the portfolio, risk tolerance and investment horizon. "Buy low and sell high" is a simple concept. However, prior literature documented behaviors in ways contrary to this concept (Ciccone, 2011; Yao et al., 2013). Although several empirical studies have noted the effects of prior investment outcomes on investors' portfolio allocation decisions, very few studies focused on the influence of prior investment outcome on stock allocations in DC plans.

Using the 2001-2013 Survey of Consumer Finances (SCF) datasets, this study fills in this research gap and examines how prior investment experience affects stock allocation in DC plans. Results show that compared with households with a prior loss and a non-positive economic expectation, those who had a prior gain were 1.9 times as likely to invest all DC plan assets in stocks. This confirmed the house money effect on stock investment in DC plans. This may help explain why some investors tend to "buy high" as opposed to following the simple "buy low and sell high" concept. Financial educators and financial fiduciaries should develop investment mechanisms and financial products to help investors avoid making investment mistakes and accumulate adequate retirement wealth.

References

- Ciccone, S. (2011). Investor optimism, false hopes and the January effect. *Journal of Behavioral Finance*, 12(3), 158-168.
- Papke, L. E. (2004). Individual financial decisions in retirement saving plans: The role of participant-direction. *Journal of Public Economics*, 88(1), 39-61.
- Yao, R., Ying, J., & Micheas, L. (2013). Determinants of defined contribution plan deferral. *Family and Consumer Sciences Research Journal*, 42(1), 55-76.

¹ Associate Professor, Department of Personal Financial Planning, 239A Stanley Hall, University of Missouri, Columbia, MO, 65211, USA. Phone: 573-882-9343. E-mail: YaoR@missouri.edu.

² Assistant Professor, Department of Accounting, Economics & Finance, West Texas A&M University Box 60809, Canyon, TX 79016, USA. Phone: 806-651-2513. slei@mail.wtamu.edu.