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Relative Portfolio Returns Influence Happiness

Whether an investor is happy or unhappy with his performance is significantly influenced by how his portfolio performs relative to the market. Investors are likely to be happy even if they lose money as long as their portfolio declines by a smaller magnitude than the broad market. Conversely, the proportion of investors likely to be unhappy rises during periods of strong market returns.

This conclusion is based on a study of British individual investors. Over 600 self-directed investors at Barclays Stockbrokers were surveyed during the period of September 2008 through September 2010. Respondents had a median age of 53 and median wealth of approximately $252,000. Answers were compared against actual returns.

The average threshold for anticipated happiness was a three-month gain of 5.4%. The average threshold for anticipated unhappiness was a three-month decline of 0.2%. Expectations for the level of returns that would lead to happiness did not alter much after the initial quarterly survey period, even though the FTSE All-Share Index (benchmark for the UK equity market) rebounded strongly from the financial crisis. Individual thresholds varied greatly; some respondents were happy even with a modestly negative return, while others required returns in excess of 20%. A strong positive relationship existed between return expectations and the minimum return an investor would be happy with.

Investors responded to returns more strongly when they actively traded than when they followed a buy-and-hold strategy, used index funds or employed an adviser or money manager. Long-term investors were happy with "much lower returns" over a three-month period than active traders were. Similarly, older, richer and more financially literate investors were happy with comparatively lower levels of returns. The study's authors theorized that higher happiness thresholds may explain why poorer and financially illiterate investors are more likely to buy "lottery stocks or take high idiosyncratic (individual) risk."

Risk tolerances and confidence also played a role. Risk-averse investors were happier with lower levels of return. Curiously, investors with lower levels of confidence set higher thresholds for happiness. The authors think this could suggest that either confident investors are more skillful and set more realistic expectations or that confidence promotes the ability to be comfortable with a lower level of returns.

Source: "Investor Happiness," Christoph Merkle, Daniel Egan and Greg B. Davies, SSRN, January 2014.

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