The Role of Financial Advisors in Shaping Investment Beliefs

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Abstract

The objective of this study is to examine the influence of financial advisors on their clients' investment beliefs. A theoretical model is first introduced, establishing a framework for how financial advisors affect the investment beliefs of their clients. The authors empirically test the theoretical model with data collected from the RAND American Life Panel. The findings, generally, suggest an association between the influence of a financial advisor and their clients' investment beliefs. The ensuing discussion highlights the need for financial advisors to be aware of their own investment beliefs, attitudes, and behaviors when working with clients. The conclusions orbit around the need for financial counseling and communication education to be cemented as a part of the broader financial planning curricula.

Introduction

Financial advisors play a critical role in facilitating the achievement of their clients' financial goals. From planning their clients' retirements to effectively managing taxes and developing insurance recommendations, financial planners develop valuable and lasting interactions with their clients when providing financial advisory services.

As a part of the financial planning process, financial advisors may work with their clients to determine appropriate investment recommendations that meet their clients' long-term financial goals. As a part of this process, financial advisors consider a broad range of information when working to develop appropriate investment recommendations, such as their client's time-horizon, age, and expected return. In addition, many financial advisors consider their clients' investing beliefs, attitudes, and perceptions as a part of the development of their financial advice.

An area of growing research interest is the formation of clients' investment beliefs and the implications of how client's investment beliefs affect client behavior. This study adds value to this research effort by examining the role of financial advisors in shaping their clients' investment beliefs. A theoretical model illustrating the formation process of financial advisors' investment beliefs is first established. This model showcases how financial advisors and behaviors are formed. Next, an additional theoretical model is presented, which introduces a robust theoretical foundation for how financial advisors serve as a contributing factor in their clients' investment beliefs. Lastly, the authors empirically test the theoretical model with newly introduced data from Choi and Robertson (2020).

Background

Investment Beliefs

Investment beliefs have been associated with a plethora of factors, such as financial literacy (Van Rooij et al., 2011), recent corporate scandals (Giannetti & Wang, 2016), risk aversion (Vissing-Jørgensen & Attanasio, 2003), and demographics (Gao, 2019; Pearson, 2020). Research has also suggested that investment beliefs are influenced by interactions, experiences, and contacts with other individuals through life. For example, the influence of parental overt and convert financial beliefs have shown to be formative in an individual's beliefs regarding money and investing (Klontz et al., 2011). Moreover, Cude et al. (2006) showed that the financial decisions of an individual's parents are a key factor in their children's money and investment beliefs.

Investment beliefs have more broadly been studied in parallel with related financial counseling research. Klontz et al. (2008) coined the term "money scripts" to refer to an individual's beliefs about money. Their research suggests that money scripts are a predictive factor in investment beliefs. Klontz and Britt (2012) go on to suggest that money scripts have both positive and negative impacts on investment beliefs, an outcome that is dependent on the "type" of money script. Types of money scripts include vigilance scripts, money anxiety scripts, and money worship scripts (Klontz & Britt, 2012; Lawson et al., 2015). Harris et al. (2021) suggests that if individuals understand their money scripts, they can

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improve their interpersonal communication. They ultimately suggest that this can even lead to improved relationship dynamics.

Financial Advisors and Investment Beliefs

The presence of financial advisors may also influence individuals' investment beliefs. The use of financial advisors has been associated with participation in equity markets (Georgarakos & Inderst, 2014). Linnainmaa et al. (2021) show that a household's likelihood of owning investment assets increases by 59.2% when households utilize financial advisors. Moreover, Kirchler et al. (2020) shows that financial advisors invest their personal assets in a similar manner as their clients' investment strategy.

Gerhardt and Hackethal (2009) add to the aforementioned research by analyzing trading data from individuals before and after receiving financial advice. They show that individuals who begin working with a financial advisor increase the likelihood that they will place less risky and speculative trades. Utilizing a survey of over 200 financial professionals, Grable et al. (2020) found that financial advisors with more experience are more likely to recommend portfolios with higher ratios of investment holdings when compared to younger financial advisors.

Research Contributions

A significant challenge in the current literature is the issue of identification. Largely, the current literature has attempted to empirically address the influence of financial advisors on their clients' investments through proxy variables, which do not directly evaluate the underlying and veritable client investment belief. For instance, research has generally suggested that individuals who utilize financial advisors invest more into equities (Linnainmaa et al., 2021; Georgarakos & Inderst, 2014). An issue of identification is created when an individual seeks the advice of a financial advisor with the goal of investing heavily into equities. Identification issues are seen in other areas of financial planning research, such as conclusions drawn in studies on income and net worth advice (Hanna, 2011, Joo & Grable, 2001), education planning (Salter et al., 2010), marriage planning (Cummings & James, 2014), and mutual fund selection (Jones et al., 2005; Ramasamy & Yeung, 2003).

This study adds value to the current literature in two overarching ways. First, this is the first study, to the authors' knowledge, that introduces a theoretical model showcasing how financial advisors can affect the investment beliefs of their clients. Secondly, this study provides empirical evidence of the connection between financial advisors and the investment beliefs of their client.

Conceptual Background

Financial Advisor Communication

Figure 1 provides a theoretical model that illustrates how financial advisors form their communication during an equity event, such as the early 2000s "dot-com" bubble, the 2007-2009 U.S. financial crisis, or the 2019-2020 COVID-19-related equity market decline. This theoretical model illustrates how financial advisors' investment beliefs are formed as a byproduct of financial advisors' own investing biases, experiences, and educational attainment. It is important to note that the weight of each influence will likely vary among financial advisors.

The formation of financial advisors' investment beliefs is a paramount consideration when examining the connection between financial advisors' investment beliefs and the interpersonal communication they engage in with their clients, especially when an equity event occurs. When an equity event occurs, an opportunity presents itself for financial advisors' interpersonal communication to affect their clients' investment beliefs. Consequently, a link is created between financial advisors' investment beliefs and their interpersonal communications.

Financial Advisor Communication and Investment Beliefs

Figure 2 builds on Figure 1, showing how the interpersonal communication between financial advisors' and their clients is an input element in the formation of new client investment beliefs. Clients have varying investing biases, experiences, and educational attainments. These influences come together to form clients' investment beliefs. When an equity event occurs, clients may engage with their financial advisors to seek advice on how to manage their investments during times of market volatility.

When clients engage in interpersonal communication with their financial advisors during equity events, clients are influenced by their financial advisor's investment beliefs. The influence of these investment beliefs can be present in both financial advisors' verbal and nonverbal communication. Consequently, financial advisors' interpersonal communication with clients during equity event results in an additive factor in the formation of new client investment beliefs.

As noted by Kolb (1984), experiences are transformed into beliefs through post-event reflection, particularly when the severity of event increases (Barnett & Pratt, 2000; Weick et al., 2005). Financial advisors who reference equity events in future communications with their clients are engaging in post-event reflection. As a result, an additional opportunity for financial advisors to influence the investment beliefs of their clients presents itself when financial advisors engage in post-event reflection with their clients.

Methodology

Data

Data collected from a survey circulated in the RAND American Life Panel (ALP) are utilized. The original purpose of the data collection was to study the determinants of portfolio investment allocation. The survey took place in December of 2016 and survey participants were paid based on anticipated survey completion time. Choi and Robertson (2020) provide a robust description of the data and the data collection process. This study uses weighted data from the sample weights provided by the RAND ALP. The sample size is 1,045.

Measures

Investment Beliefs

Survey participants are first asked, "How important are the following factors in determining the percentage of your investable financial assets that is currently invested in stocks?" For each factor, respondents can answer: 1 (Not important at all), 2 (A little important), 3 (Moderately important), 4 (Very important), and 5 (Extremely important). This study examines two equity event investment beliefs.

The first investment belief examined comes from the question, "The feelings, attitudes, and beliefs about the stock market I've gotten from living through stock market ups and downs" (Ups & Downs). The second investment belief examined comes from the question, "The feelings, attitudes, and beliefs about the stock market I've gotten from my personal experiences of investing in the stock market" (Personal Experiences).

Influence of Financial Advisor (FA)

To assess whether financial advisors exert influence on their clients' investment beliefs, this study examines whether survey participants consider financial advisors important in determining their investment allocation (FA Influence). Survey participants are asked, "How important are the following factors in determining the percentage of your investable financial assets that is currently invested in stocks?" The FA Influence variable is derived from the responses to the question, "Advice from a professional financial advisor I hired." Respondents could have answered: 1 (Not important at all), 2 (A little important), 3 (Moderately important), 4 (Very important), and 5 (Extremely important).

Controls

The control variables utilized in this study include educational attainment, age, gender, racial identification, marital status, income, and investable assets. Educational attainment has been shown to influence financial literacy (Huston, 2010) and financial literacy has been shown to influence investment beliefs (Mandell & Klein, 2009). Age also is an important variable to consider because as individuals age, they enter different periods of their life-course. As individuals enter those periods, their beliefs, attitudes, and perceptions are expected to restructure to match their current stage of life-course. Demographic background, such as gender and race, have been shown to influence investment perceptions (Pearson, 2020; Bhavani & Shetty, 2017). Investment beliefs, such as risk tolerance, have been shown to be influenced by marital status (Yao & Hanna, 2005). Varying levels of income and investable assets are expected to produce new investment perspectives, and, thus, are also included as controls.

Empirical Model

To understand the role of financial advisors in shaping the investments beliefs of their clients, the following two ordered probit regression models are estimated:

$$Ups\ \&\ Downs_i^* = \beta_0 + \beta_1 FAInfluence_i + \beta_j DV_j + \varepsilon_i$$

$$Ups\ \&\ Downs_i = \begin{cases} 1\ if\ Ups\ \&\ Downs_i^* > 0 \\ 0\ if\ Ups\ \&\ Downs_i^* \leq 0 \end{cases}$$

$$Personal\ Experiencesi_i^* = \beta_0 + \beta_1 FAInfluence_i + \beta_j DV_j + \varepsilon_i$$

$$Personal\ Experiences_i = \begin{cases} 1\ if\ Personal\ Experiences_i^* > 0 \\ 0\ if\ Personal\ Experiences_i^* \leq 0 \end{cases}$$

where $Ups\ \&\ Downs^*$ and $Personal\ Experiences^*$ are latent while $Ups\ \&\ Downs$ and $Personal\ Experiences$ are observed measures of investment beliefs that are rooted in experience with historic equity events.

To capture any potential influence financial advisors may have on the respondent's investment beliefs, the $FAInfluence$ variable takes the form of a dichotomous variable by assigning a value of "0" for all 1 responses and a "1" for all 2, 3, 4, and 5 responses.

The matrix DV_j contain the controls utilized in the models. The controls include whether the survey participant has a 4-year college degree, a continuous measure for age, whether the survey participant is male, whether the survey participant is white, whether the survey participant is married, and categorical measures for income and wealth. The categorical measure for income utilizes the reference category $0-$9,999, to which values of $10,000 - $24,999, $25,000 - $39,999, $40,000 - $74,999, and $75,000 + are compared. The investable assets variable was developed from the question, "What is the value of all your investable financial assets?" The categorical measure for wealth utilizes the reference category $0 - $999, to which values of $1,000 - $9,999, $10,000 - $49,999, $50,000 - $99,999, and $100,000 + are compared.

Each of the models are estimated via maximum likelihood. Average marginal effects are calculated to determine the magnitude of the effects. The error term is assumed to follow the standard normal distribution.

Results

Summary Statistics

Table 1 provides the summary statistics of the sample. The averages for the level of importance for the Ups & Downs investment belief are as follows: 23% "Not Important," 19% "A Little Important," 31% "Moderately Important," 19% "Very Important," and 8% "Very Important." The averages for the level of importance for the Personal Experiences investment belief are as follows: 19% "Not Important," 17% "A Little Important," 33% "Moderately Important," 21% "Very Important," and 10% "Very Important."

Other summary findings reveal that 62% of respondents ranked the FA Influence at "A Little Important" or greater. 50% of the sample holds at least a 4-year college degree, 47% of the sample are male, 82% are white, 58% are married, and the average age is 57. For the categorical income variable, 6% have income between $0-$9,999, 15% have income between $10,000 - $24,999, 22% have income between $25,000 - $39,999, 20% have income between $40,000 - $74,999, and 37% have income over $75,000. For the categorical investable assets variable, 14% have investable assets between $0-$999, 12% have investable assets between $1,000 - $9,999, 16% have investable assets between $10,000 - $49,999, 11% have investable assets between $50,000 - $99,999, and 46% have investable assets over $100,000.

Main Econometeric Results

Table 2 presents the average marginal effects from the Ups & Downs ordered probit regression. For brevity, only the Not Important and Extremely Important average marginal effects are reviewed. For the Ups & Downs investments belief regression, the FA Influence variable was associated negatively with the Not Important response with an average marginal effect of -0.2010 ($p < 0.001$). For the Ups & Downs investments belief regression, the FA Influence variable was associated positively with the Extremely Important response with an average marginal effect of -0.1065 ($p < 0.001$).

Table 3 presents the average marginal effects from the Personal Experiences ordered probit regression. For the Personal Experiences investments belief regression, the FA Influence variable was associated negatively with the Not Important response with an average marginal effect of -0.1434 ($p < 0.001$). For the Personal Experiences investments belief regression, the FA Influence variable was associated positively with the Extremely Important response with an average marginal effect of 0.1011 ($p < 0.001$).

Other Econometeric Results

Other results from the regression analysis provide other associations to note. For brevity, only the Not Important and Extremely Important average marginal effects are reviewed. For the Ups & Downs ordered probit regression, being male was associated negatively with the Not Important response with an

average effect of -0.0479 ($p < 0.05$). Being male was associated positively with the Extremely Important response with an average marginal effect of 0.0254 ($p < 0.05$).

For the Personal Experiences ordered probit regression, being male was associated negatively with the Not Important response with an average effect of -0.0399 ($p < 0.05$). Being male was associated positively with the Extremely Important response with an average marginal effect of 0.0281 ($p < 0.05$). A one-year increase in age was associated negatively with Not Important with an average effect of -0.0014 ($p < 0.05$). A one-year increase in age was associated positively with the Extremely Important response with an average marginal effect of 0.001 ($p < 0.05$).

Discussion

Discussion of Results

This study analyzed the role of financial advisors in the formation of their clients' investment beliefs utilizing newly introduced data from Choi and Robertson (2020). The empirical findings suggest that considering the advice of a financial advisor as "influential" in making investment decisions is associated with an individual's investment beliefs. Other results showed that males compared to females, generally, consider the "ups-and-downs" of the market and their own personal investing experience when investing. Increases in age showed similar results for considering personal experiences when investing, however, the results for increases in age and the consideration of the "ups-and-downs" of the market when investing did not result in a statistically significant association.

Limitations

Despite the findings and the contributions, an empirical limitation to note is that the data only provided a measure assessing the value of survey participants' investable assets. The data did not provide a measure assessing the net worth of the survey participants. As noted by Klontz and Britt (2012), net worth has been associated with money beliefs, such as money status and money worship beliefs. Although investable assets and net worth are likely correlated, a measure for net worth would have provided a better control.

Implications

Financial advisors play a critical role in facilitating the achievement of their clients' financial goals. One of the ways that financial advisors act as facilitators is in their input in shaping their clients' investment beliefs, attitudes, and behaviors. Financial advisors should be aware of their own investment beliefs, attitudes, and behaviors and the impact they have in influencing their clients' beliefs, attitudes, and behaviors. Moreover, financial advisors should understand how their beliefs are both overtly and covertly communicated when working with their clients.

As noted by Kolb (1984), experiences are transformed into beliefs through post-event reflection, particularly when the severity of the event increases (Barnett & Pratt, 2000; Weick et al., 2005). When financial advisors reflect on historic equity market events with their clients, such as the early 2000s dot-com bubble, the 2007-2009 financial crisis, or the 2019-2020 COVID-19-related investment downtown, financial advisors should consider how the reflection of those events with their clients play a role in shaping their clients' beliefs.

Training in financial counseling and communication can offer support to financial advisors in developing greater self-awareness. Furthermore, trainings designed to teach self-reflection and self-discovery provides an opportunity for financial advisors to assess their own beliefs and how those beliefs may be communicated in their work with clients. Financial counselors and financial therapists have a unique opportunity to provide financial advisors with these trainings.

An additional avenue for training financial advisors lies in financial planning education programs. Financial planning education programs that incorporate financial counseling and communication as a part of their core curricula provide current and future financial advisors with an opportunity to further explore and develop their understanding of their investment beliefs, attitudes, and perceptions.

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Figure 1 – Financial Advisor Communication Model

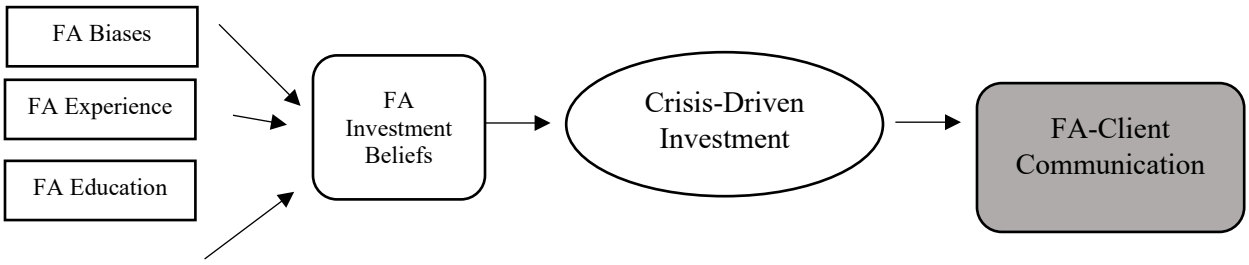

Figure 2 – Client Investment Belief Formation during Equity Events

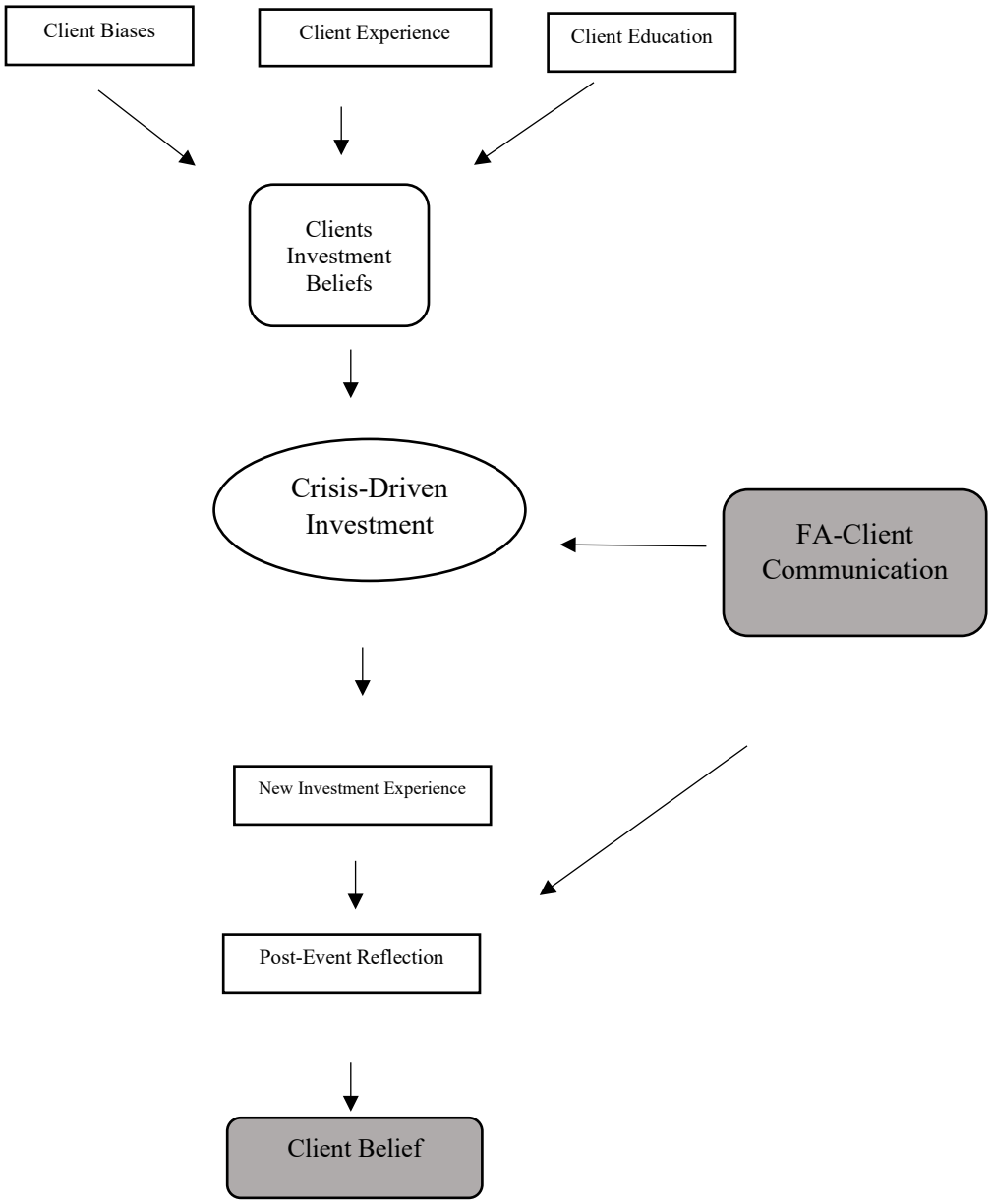

Table 1 - Summary Statistics of Sample

	Averages	Standard Dev.
Ups & Downs		
Not Important	22.85% (Categorical)	
A Little Important	19.22% (Categorical)	
Moderately Important	31.07% (Categorical)	
Very Important	18.93% (Categorical)	
Extremely Important	7.93% (Categorical)	
Personal Experiences		
Not Important	18.74 % (Categorical)	
A Little Important	16.73% (Categorical)	
Moderately Important	33.08% (Categorical)	
Very Important	21.03% (Categorical)	
Extremely Important	10.42% (Categorical)	
FA Influence	61.91 (%)	48.58
College Degree	49.90 (%)	50.02
Age	56.57 (Continuous)	14.02
Male	47.04 (%)	49.94
White	81.84 (%)	38.57
Married	58.32 (%)	49.33
Income		
$0 - $9,999	5.93% (Categorical)	
$10,000 - $24,999	14.82% (Categorical)	
$25,000 - $39,999	22.28% (Categorical)	
$40,000 – $74,999	20.08% (Categorical)	
$75,000 +	36.9% (Categorical)	
Investable Assets		
$0 - $999	14.44% (Categorical)	
$1,000 - $9,999	12.14% (Categorical)	
$10,000 – $49,999	16.06% (Categorical)	
$50,000 - $99,999	11.19% (Categorical)	
$100,000 +	46.18% (Categorical)	

Significance is defined as follows: * significant at $p < 0.05$; ** significant at $p < 0.01$; *** significant at $p < 0.001$

Data collected from the RAND American Life Panel (ALP) 2016

N = 1,045

Table 2 - Average Marginal Effects from Ordered Probit Regression: Ups & Downs

	Ups & Downs				
	Not Important (Standard Errors)	A Little Important (Standard Errors)	Moderately Important (Standard Errors)	Very Important (Standard Errors)	Extremely Important (Standard Errors)
FA Influence	-0.2010***	-0.0603***	0.0420***	0.1128***	0.1065***
	(0.019)	(0.0072)	(0.007)	(0.0113)	(0.0133)
College Degree	-0.0283	-0.0085	0.0059	0.0159	0.0150
	(0.0202)	(0.0061)	(0.0043)	(0.0113)	(0.0108)
Age	-0.0009	-0.0003	0.0002	0.0005	0.0005
	(0.0007)	(0.0002)	(0.0002)	(0.0004)	(0.0004)
Male	-0.0479*	-0.0144*	0.0100*	0.0269*	0.0254*
	(0.0187)	(0.0057)	(0.0042)	(0.0106)	(0.0101)
White	-0.0005	-0.0001	0.0001	0.0003	0.0002
	(0.0252)	(0.0076)	(0.0053)	(0.0142)	(0.0134)
Married	-0.0322	-0.0097	0.0067	0.0181	0.0171
	(0.0211)	(0.0064)	(0.0045)	(0.0119)	(0.0112)
Income ($0 - $9,999 base)					
$10,000 - $24,999	-0.0499	-0.0103	0.0152	0.0256	0.0195
	(0.0532)	(0.0098)	(0.0177)	(0.0263)	(0.0193)
$25,000 - $39,999	-0.0945	-0.0243*	0.0243	0.0510	0.0435*
	(0.0534)	(0.0105)	(0.018)	(0.0268)	(0.0199)
$40,000 – $74,999	-0.05372	-0.0113	0.016155	0.02762	0.021247
	(0.0575)	(0.0104)	(0.0191)	(0.0285)	(0.0204)
$75,000 +	-0.0774	-0.0183	0.0214	0.0409	0.0334
	(0.0583)	(0.0113)	(0.0191)	(0.0294)	(0.0213)
Investable Assets ($0 - $999 as base)					
$1,000 - $9,999	0.0171	0.0034	-0.0055	-0.0087	-0.0063
	(0.0419)	(0.0084)	(0.0134)	(0.0214)	(0.0155)
$10,000 – $49,999	-0.0454	-0.0121	0.0119	0.0250	0.0207
	(0.0397)	(0.0103)	(0.0113)	(0.0216)	(0.0175)
$50,000 - $99,999	-0.0385	-0.0100	0.0104	0.0210	0.0171
	(0.0442)	(0.0114)	(0.0124)	(0.024)	(0.0194)
$100,000 +	-0.0648	-0.0189	0.0154	0.0365	0.0318
	(0.0402)	(0.0107)	(0.0114)	(0.022)	(0.0177)

Significance is defined as follows: * significant at p < 0.05; ** significant at p < 0.01; *** significant at p < 0.001
Data collected from the RAND American Life Panel (ALP) 2016
N = 1,045

Table 3 - Average Marginal Effects from Ordered Probit Regression: Personal Experiences

	Personal Experiences				
	Not Important (Standard Errors)	A Little Important (Standard Errors)	Moderately Important (Standard Errors)	Very Important (Standard Errors)	Extremely Important (Standard Errors)
FA Influence	-0.1434***	-0.0573***	0.0113*	0.0882***	0.1011***
	(0.0176)	(0.0078)	(0.0056)	(0.0107)	(0.014)
College Degree	-0.0225	-0.0090	0.0018	0.0138	0.0159
	(0.0182)	(0.0073)	(0.0017)	(0.0112)	(0.0128)
Age	-0.0014*	-0.0005*	0.0001	0.0008*	0.0010*
	(0.0006)	(0.0003)	(0.0001)	(0.0004)	(0.0005)
Male	-0.0399*	-0.0160*	0.0032	0.0246*	0.0281*
	(0.0168)	(0.0068)	(0.002)	(0.0104)	(0.012)
White	-0.0194	-0.0078	0.0015	0.0120	0.0137
	(0.0226)	(0.0091)	(0.0019)	(0.0139)	(0.016)
Married	0.0019	0.0008	-0.0001	-0.0012	-0.0013
	(0.0189)	(0.0075)	(0.0015)	(0.0116)	(0.0133)
Income ($0 - $9,999 base)					
$10,000 - $24,999	-0.0543	-0.0144	0.0145	0.0298	0.0245
	(0.0506)	(0.0121)	(0.0157)	(0.0267)	(0.0209)
$25,000 - $39,999	-0.1022*	-0.0333*	0.0200	0.0596*	0.0560*
	(0.0507)	(0.0129)	(0.0163)	(0.0272)	(0.0218)
$40,000 – $74,999	-0.0703	-0.0200	0.0173	0.0394	0.0337
	(0.0545)	(0.0133)	(0.0167)	(0.0291)	(0.0226)
$75,000 +	-0.1072	-0.0356*	0.0200	0.0628*	0.0600*
	(0.0548)	(0.0146)	(0.0162)	(0.0299)	(0.0243)
Investable Assets ($0 - $999 base)					
$1,000 - $9,999	-0.0073	-0.0025	0.0014	0.0043	0.0041
	(0.0362)	(0.0123)	(0.0068)	(0.0215)	(0.0202)
$10,000 – $49,999	-0.0388	-0.0148	0.0051	0.0240	0.0246
	(0.0351)	(0.0131)	(0.0061)	(0.0215)	(0.0214)
$50,000 - $99,999	0.0177	0.0055	-0.0039	-0.0102	-0.0090
	(0.0416)	(0.0129)	(0.0092)	(0.024)	(0.0214)
$100,000 +	-0.0546	-0.0221	0.0054	0.0343	0.0370
	(0.0354)	(0.0135)	(0.006)	(0.022)	(0.0216)

Significance is defined as follows: * significant at p < 0.05; ** significant at p < 0.01; *** significant at p < 0.001
Data collected from the RAND American Life Panel (ALP) 2016
N = 1,045

Appendix

All questions are lead with, “How important are the following factors in determining the percentage of your investable financial assets that is currently invested in stocks?”

Dependent Variables

Ups & Downs

The feelings, attitudes, and beliefs about the stock market I’ve gotten from living through stock market ups and downs (whether or not I was invested in stocks at the time).

1 Not important at all
2 A little important
3 Moderately important
4 Very important
5 Extremely important

Personal Experiences

The feelings, attitudes, and beliefs about the stock market I’ve gotten from my personal experiences of investing in the stock market.

1 Not important at all
2 A little important
3 Moderately important
4 Very important
5 Extremely important

Primary Explanatory Variable

FA Influence

Advice from a professional financial advisor I hired.

1 Not important at all
2 A little important
3 Moderately important
4 Very important
5 Extremely important