

# Personal Saving and Portfolio Decisions in an Era of Individual Choice

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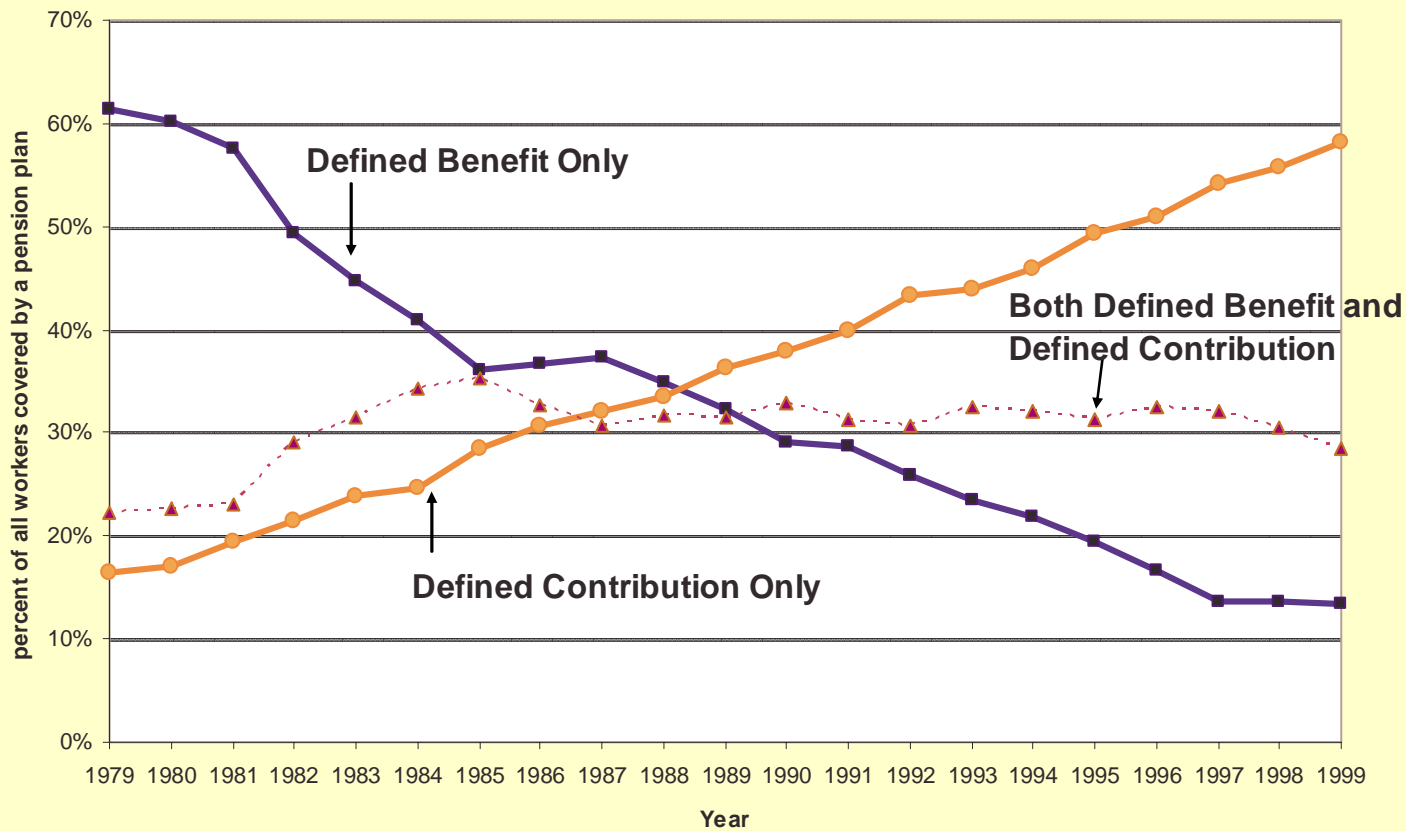
The responsibility for saving and portfolio allocation decisions is increasingly falling on individuals

- Increase in years spent in retirement
- Rise of DC pensions
- Possibility of Social Security privatization

# Increase in the length of the retirement period

- Occurring because individuals are
  - Retiring at an earlier age
  - Living longer
- Result: The need for retirement saving is increasing

# In the US, participation in DC pension plans has risen dramatically



Source: Department of Labor, form 5500 reports

# More households are choosing to own stock than ever before

## Percentage of US households owning stock

1962	1989	1992	1995	1998	2001
~23.9%	33.3%	37.6%	41.3%	49.4%	52.2%

Source: Ameriks/Zeldes (2004), based on 1962-2001 Surveys of Consumer Finances

The U.S. is considering replacing part of Social Security with personal accounts, owned and managed by individuals

- “We must strengthen Social Security by allowing younger workers to save some of their [Social Security] taxes in a personal account -- a nest egg you can call your own, and government can never take away.”

George W. Bush, Republican Convention Acceptance Speech, 9/2/04

Overall: a dramatic increase in the importance of individual saving and portfolio decisions

- Implications for
  - Individual households
  - Financial institutions
  - Policymakers

# Choices Facing Individuals

- How much to save?
- What fraction of financial wealth to invest in stocks?
  - How should this vary with age and other demographic factors
- How much to diversify?
  - Across stocks or mutual funds
  - Company stock
- How active an investor to be?
  - Individual stocks
  - Actively managed mutual funds
  - Index funds
- Whether to annuitize?

## Two key questions

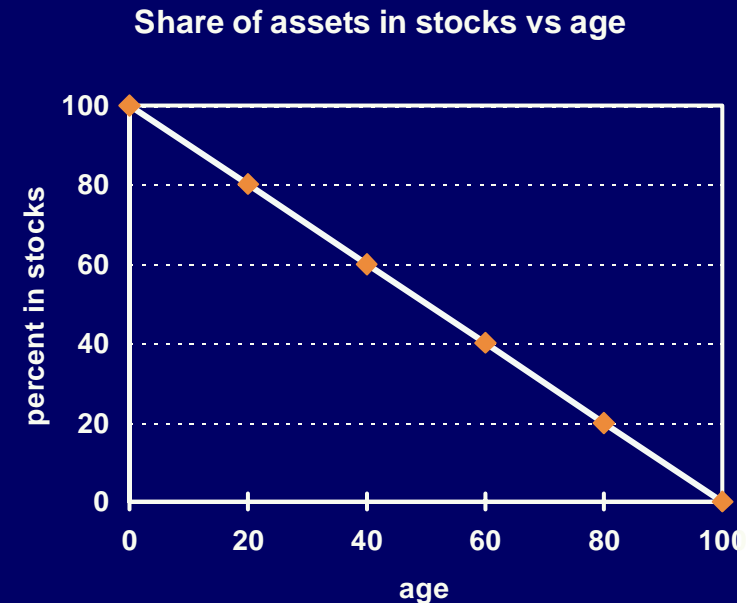
- What **should** individuals do?
- What **do** individuals do?

We do not have good answers to either of these questions

- Much financial advice is not based on serious economic / financial analysis
- Just beginning to learn about how individual investors actually behave
- Both are wide open research questions, with lots of recent activity

## Example: Variation with Age

- Professional advice is nearly unanimous: the longer your investment horizon, the greater your exposure to stocks should be
- Typical rule of thumb:  
**Stocks/financial assets = 100 – age**
- Virtually no serious industry analysis backing up this advice
- Ameriks/Zeldes (2004) investigate what individuals do as they age



## Answering these questions

- Serious players in the international financial arena must be involved in answering both of these questions (“should” and “do”)
- The best way of doing this is through joint efforts between experts in the private sector and in academia

# Answering these questions

- What should people do?
  - Requires sophisticated mathematical models
  - Need to incorporate features not typically considered
    - Risky human capital, housing, family structure, entrepreneurship, taxes (Stiglitz, 2004)
  - Recent research has been moving in this direction
  - May point to creation of new types of securities
- What do people do?
  - Requires sophisticated econometric analysis
  - Good data

# U.S. Datasets: saving, wealth, portfolio choice

- **Public Datasets**

- Survey of Consumer Finances (SCF)
- Panel Study on Income Dynamics (PSID)
- Health and Retirement Survey (HRS)
- Survey of Income and Program Participation (SIPP)

- **Private**

- Employee Benefit Research Institute / Investment Company Institute 401(k) data (Vanderhei, et. al.)
- Hewitt and Associates (Laibson, et. al.)
- Vanguard (Huberman, et al)
- TIAA-CREF (Ameriks and Zeldes)

# Survey Data vs Administrative Records

- Survey Data
  - Easier to get representative sample of individuals
  - Better picture of entire household balance sheet
  - Richer demographic information
- Administrative Records
  - More accurate (less measurement error)
  - But typically only measure a subset of assets

## Ideal situation: Survey Data AND Administrative Records

- Combination yields
  - Picture of entire portfolio
  - Rich demographics
  - Very accurate data
- Unicredit Survey is an important step in this direction