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ARE WOMEN BETTER INVESTORS?

by Gifford Lehman

The facts say yes. Recent research by Terrance Odean, professor at the University of California at Davis, shows evidence that, as a group, women's stock portfolio's perform better than men's by 1.4% per year. That may not sound like much, but if you were a Wall Street portfolio manager and you consistently beat the competition by 1.4%, you'd be getting paid the big bucks right now.

Does this mean that women are better investors because they are smarter? Being male, I am not quite willing to jump to this potentially obvious conclusion. In fact, the research sited above (Professor Odean is male, by the way, and may be as biased as I am) concludes that it is not because women are so smart, it is just that men are foolishly overconfident. Well, now that you think about it, maybe that is the same thing as women are smarter.

Professor Odean and his colleague Brad Barber note in their research that men feel more confident in things financial and they consequently believe that they can beat the market. This belief results in active trading behavior. Women, they found, tend to feel more intimidated and as a consequence they leave their investment portfolios alone.

Professor Odean found that regardless of gender, the more people trade their portfolios, the less money they make. He found that the stocks people sold performed 3.4% <u>better</u> than the stocks they purchased over the following year! And this is before both transaction costs and taxes!

There is a theory why the stocks sold outperformed the stocks purchased. It has to do with what behavioral finance people call "loss aversion". (Behavioral finance is the study of how people behave financially.) They found that people have a natural reluctance to admit mistakes and a propensity to capitalize on successes.

It works like this. Suppose you have two investments, one with a 50% gain and one with a 50% loss. The theory says people tend to sell their winners and to hang on to their losers. Selling a winner locks in your gain and gives you bragging rights. By refraining from selling the losing position, you can avoid admitting you made a mistake. The thought process is, "If I just give it more time, this stock will come back and I can at least break even".

Regardless if this theory is correct, regardless if women are smarter than men, there is an important lesson here for all investors. That lesson is that we know much less than we give ourselves credit for and it is extraordinarily difficult to beat the market on a consistent basis.

As an investment advisor, one of the things I constantly emphasize to my clients is that a key to investment success is understanding the limits of your knowledge. The reason for this is that if you know the limits to your knowledge, you won't be tempted to incur costs unnecessarily. When contemplating an investment trade, you should ask yourself what the basis is for what you “know”. “Know” is in quotes because if you really answer this question honestly, you will probably discover that you don’t “know”.

Is your “knowledge” just a gut feel? If so, then do you really want to incur transaction costs and pay taxes to make the trade? Is your “knowledge” something that is generally known to the rest of the investing public? (Anything told to you by your broker or that you read in a newspaper, magazine, or online is by definition known to the rest of the investing public.) If so, then doesn’t the current price already reflect this information?

Professor Odean indicated that women outperform men by 1.4% annually simply because they trade less. He found no evidence that they trade stocks better. In fact he found that if people didn’t trade at all, they would have performed about 5% better - the 3.4% cited above plus transaction costs.

This is not advice to do nothing. My point is that once you have established an investment portfolio based upon your financial goals and your tolerance for risk, don’t trade your portfolio based on things you don’t really “know”. Trade your portfolio based upon things you do know, such as changes in your financial goals, your ability to tolerate risk, or your overall financial situation.