Faculty of Business and Law

2020 Australian Government Research Training Program Scholarships

Strategic Project Profile

PROJECT TITLE: Their Own Worst Enemies. Behavioural Finance and the Investments of Australian Households

FIELD OF RESEARCH CODE: 1502

PROJECT SYNOPSIS: The Australian Productivity Commission (APC) recently noted that “super[annuation] has been a large and compulsory public policy endeavour, yet there is remarkably little publicly available data on the outcomes that individual members are actually experiencing — in terms of the returns they earn, the fees they pay, the insurance they hold and the outcomes they receive over time” (Australian Productivity Commission (APC), 2018. P. 21). Recent evidence suggests that the system is failing. The World Economic Forum finds that Australian men will outlive their savings by 10 years, women by 12 (World Economic Forum, 2019, p. 21).

The APC (2018) blames superannuation funds for poor investor outcomes. However, the issues the APC raises – high fees and relative underperformance – are very well documented in the academic literature and can be easily addressed. Fund underperformance might simply be addressed through passive investing. For example, an investor could simply purchase shares in a well-diversified fund such as the iShares Core S&P/ASX 200 Exchange Traded Fund (ASX code: IOZ) to gain exposure to well diversified benchmark index that most funds find extraordinary difficult to match, let alone outperform. Such a strategy would also address high fees. This iShares fund charges a management fee of 0.15% per annum; such low fees are typical of these passive strategies. In contrast, Australian funds charge between 1 and 2% per annum (APC, 2018,p. 16) and these fees cost Australians $30 billion annually, excluding insurance premiums (APC, 2018, p. 15).

The APC report is correct to highlight something that, in the Australian context is not well understood at all. There is a gap in our understanding of the behaviour of individual investors (households) and the outcomes they receive. This latter observation is challenging. Our project would seek to address this gap.

Behavioural Finance has boomed since the late 1980's and, although its precise definition is still debated, it broadly involves the application of psychology to modelling financial markets and investor activities. Our working hypothesis is that Australian investors will exhibit similar sub-optimal investment behaviour as has been observed overseas. For example, Calvert, Campbell and Sodini (2007) document the very poor state of Swedish household portfolios: they areinordinately risky and undiversified. Durand, Newby and Sanghani (2008) present similar evidence for a sample of Australian investors.

Behavioural Finance would suggest that investors' own actions lead to sub-optimal investment outcomes. In other words, investors are their own worst enemies when it comes to investment. Recent evidence, for example, suggests that the more investors look at their portfolios, the less likely they are to expose themselves to risk (Durand, Fung and Limkriangkrai, 2019). Investors must expose themselves to a certain level of risk to achieve their desired investment outcomes. Therefore, not looking at their investments is an excellent strategy; this would reduce the unnecessary rebalancing of portfolios towards lower risk option and this should improve investors' wealth, especially in the long term. It pays to be slothful!

The project would examine the behaviour of Australian investors using theories and methodologies from Behavioural Finance. In particular, we would seek data from a large investment house and model the portfolios of investors over time. In doing so, we would document systematic biases leading to sub-optimal outcomes. The project might readily be extended to FinTech through examining the influences of this particular source of information on investor behaviour.

In the standard textbook on Behavioural Finance, John Nofsinger writes that "successful investing is more than just knowing all about stocks. Indeed, understanding yourself is equally important. Knowledgeable investors frequently fail because they allow their psychological biases to control their decisions." (Nofsinger, 2017, pp. 171-175). In documenting the biases and behaviours of Australian investors, this study can provide important advice for Australian investors and their advisers.

FEASIBILITY AND RESOURCING – DESCRIPTION OF THE SUPPORT THIS PROJECT WILL RECEIVE:

The Project linked domestic students will receive a base level RTP funded living stipend, a RTP fee offset (domestic) tuition stipend and also receive a mobility allowance of $5000, an additional $2000 for digital supports and some strategic research funding for minor research consumables.
The faculty will provide a laptop, shared work space and research training (where needed).

WHAT MINIMAL ATTRIBUTES AND SKILLS EXPECTED BY THE CANDIDATE BE COMPETITIVE:

Honours I or IIA or higher.
Knowledge of, or the ability to acquire knowledge of, literature in behavioural finance.
Knowledge of SAS or the ability to acquire such knowledge.
Knowledge of Stata (or a similar package) or the ability to acquire such knowledge.

THE SIGNIFICANCE OF THE PROJECT/ PROGRAM FOR THE ENROLLING SCHOOL OR INSTITUTION:

Finance and Banking is an area of research strength at Curtin Business School and, within this discipline, there is considerable expertise within Behavioural Finance modelling of the behaviour of individual investors and households using Behavioural Finance.

The project will both increase the School's capacity in the area of Behavioural Finance and provide the opportunity for the successful scholarship winner to become internationally competitive in this important area of Finance. Finance has increased its ERA rating to world class in the 2018 ERA assessment and the faculty is supporting this achievement through their support of this project proposal.

Students are advised to contact the Project Lead listed below prior to submission of their scholarship application to discuss their suitability to be involved in this strategic project.

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