Chapter 2 Literature Review

2.1 Current Marketing Research

We begin the review by first looking at the current literature relative to marketing in the world of investments. While it may still be too early to fully understand the marketing effect from the 2008-2009 recession felt by U.S. investors, it certainly can't be ignored that the investment landscape has changed. Investors that previously thought their investments were relatively safe got a front row seat to a lesson about the amount of money that could be lost in a relatively short period of time. Additionally, the scandals of Wall Street, have shown investors and regulators alike what was happening behind the scenes at many of the largest investment firms. While this paper does not intend to look at the causes of the recession, it can certainly be argued that a lack of knowledge by investors and those making the investments certainly was shown throughout the downturn. The question of what this means for marketers is of the utmost important as financial firms look to regain investor's trust and most importantly, their investible assets.

To start this discussion we can look at how investors are influenced by marketing and then discuss how that might influence their behavior moving forward through what many hope to be a recovering market. Investment firms fall into the general category of service firms and therefore face many of the same issues of other service firms. The traditional view is that service firms suffer from distinguishing characteristics from their product driven counterparts in terms of intangibility, inseparability, heterogeneity and perishability. These characteristics have been refuted and even referred to as the four service marketing myths (Vargo and Lusch 2004). These characteristics do not distinguish services from goods, argue Vargo et al. It is the service characteristics that should dominate the marketing discussion moving forward. There is certainly a large amount of credibility given to the argument by Vargo and Lusch, however, it still can not be ignored that in terms of marketing their product, investment firms not only suffer from the lake of a tangible product to promote, but also need to sell a service they can't guarantee that they can provide. Vargo and Lusch make a strong argument for services which can be largely controlled by the firms that provide them, however, in the investment world it is often difficult to duplicate past performance, if not impossible. Therefore the world of investment services may not only be outside the scope of traditional manufacturing goods but also outside many other traditional services. This brings to the forefront an interesting study published in 2007 that looks at the impact advertising has on investor perceptions and subsequent performance of the mutual funds.

In a study looking at the impact mutual fund advertising has on quality and price, (Jones, Lesseig, Smythe and Taylor 2007) researchers found a negative relationship between the advertising of funds and their subsequent performance. The performance of funds that advertised outperformed their non-advertising counterparts prior to the advertisements. After the advertisements appeared, however, the funds that advertised significantly underperformed their non-advertised counterparts (Jones et al.). This finding should be viewed in conjunction with other work that found that brand awareness and brand image play a central role in the processing of ads and are able to distort private investors risk perception (Jordan and Kaas 2002).

Emotional stimuli in an ad leads to a more favorable, positive affective evaluation of the advertised mutual funds, but also a lower perception of risk (Jordan et al.). The combination of these two studies unveils a potentially disturbing trend that advertising is influential in promoting trust and positive perception of an investment firm, but that the advertising may lead to investors contributing to funds that will then demonstrate poor performance. Although the reason for the poor performance can't be precisely pinpointed, it certainly can be argued that the advertising adds to the underlying expense of the funds. These expenses have a negative impact on the performance of the mutual funds as the expenses are taken from the funds investment performance.

When pairing these findings with those of Qihua Lin (2004) who determined that "Active information searchers tended to be those who were not as confident in their own knowledge about investments and those who possessed larger amounts of investment assets" there is potential for a large audience to be greatly affected by marketing efforts of investment firms. This could potentially mean that investors with the least confidence in their own knowledge are affected the greatest by advertising that seemingly puts trust and confidence in investments that have a tendency to underperform after being advertised. Looking at the differences in purchasing a non-tangible good like financial investments, Lin looked at the age, education, novelty seeking, attitude toward risk and income level as factors that could influence the consumer information search. This review was done in terms of literature, media, the internet, friends/family and professional financial services providers. This represents a fairly exhaustive coverage of information outlets and factors, but failed to look specifically at investment knowledge. Lin does discuss those people that are not confident in their investment knowledge versus those that are, however, confidence and knowledge are not necessarily equal. Her findings are nonetheless informative as she believes that those people selling investment products need to target those consumers that actively search for information, that have a lower subjective level and are willing to take substantial risks for higher returns. Her study categorizes them as 48 to 50 years old with a household income of $35,000. Although this scope is too narrow for any marketer to effectively influence their company's bottom line, it is important in that seeking those people who are actively searching for information but have little knowledge, would seem to be a positive marketing strategy. Also a substantial point made by Lin is that "it is necessary to teach consumers to accurately assess their own knowledge about investments since the extent of information search will decrease as subjective knowledge increased. Especially, overconfidence with their own knowledge will make themselves underestimate the importance of information search and potentially make risky investment decisions without sufficient information. While Lin and others have studied the issue from the viewpoint of the investor and how they can best benefit from their investment choices, what is rarely discussed is how investment firms can fill the investment knowledge gap.

One important knowledge gap, and one which some investment firms may be shy to discuss, is in the area of fees. Only 60.7 percent of mutual fund investors know if their investments were load or no load funds (Capon, Fitzsimons, Prince 1995). No load funds are generally considered to be funds that charge no upfront sales charge and minimal, if any, redemption charges. Their fees are collected in annual operating expenses. Loaded funds are generally considered to charge upfront fees (capped at 5.75 percent in the United States) and often have back-end charges as well. Loaded funds are often sold through intermediaries that receive some of the sales charge as compensation. This relatively simple concept is crucial for investors to understand how they are being charged and how those charges can affect their investments. Most research by investors is related to risk and return and models of investor behavior that focus solely upon return and risk are at best, a naïve vehicle for understanding the mutual fund investment process (Capon et al.). The research done by investors is then primarily outside the scope of fees even though fees can have a substantial impact on returns. Fees are just one area that investors may be uninformed, but for investment firms who strive to keep fees low, this could be an excellent marketing area to promote their product while increasing the knowledge of investors.

2.2 Current Market

It is also important to look at the state of the investment market and some characteristics of the U.S. investor. This is important to understand what type of person may be a potential investor and what characteristics might make someone more likely to invest. Large investment firms have tried to review what it takes to create a need for investors to invest with their firm and often look to establish emotional bonds either through the deployment of sales staff that take on the financial advisor role, or through an emotional appeal such as secure retirement or the satisfaction of paying for your children's college education. Whichever current tactic an investment company employs, it almost certainly is an emotional one. This leaves the rational sales model, one that looks to educate and diplomatically advise the potential client in a rational format which is currently an underused avenue for marketing.

The current investment market offers a substantial business opportunity for firms in terms of size and influence. There is little doubt that U.S. based investment companies provide a significant influence to the domestic economy and certainly also to economies abroad. Although the economic crisis of 2008 and 2009 showed that even though the U.S. investment firm's influence is felt around the globe, the results are not always positive. U.S. registered investment companies managed more than $10 trillion in assets at the end of 2008 for 93 million U.S. investors (Investment Company Institute, Investment Company Fact Book, 2009). These investment funds supplied investment capital in securities markets around the world and were among the largest group of investors in the U.S. stock, commercial paper, and municipal securities markets (Investment Company Institute, Investment Company Fact Book, 2009).

"A $2.6 trillion decrease in managed assets was experienced from year-end 2007. Major U.S. stock price indexes declined about 40 percent during the year, significantly lowering total net assets of funds invested in domestic equity markets. Declines in stock prices abroad had a similar effect on funds invested in foreign stocks. U.S. stock and bond funds holding international assets decreased further from the strengthening of the U.S. dollar and the resulting decrease in the dollar value of foreign securities. Including funds offered in foreign countries, worldwide mutual fund assets decreased by $7.2 trillion to $19.0 trillion as of year-end 2008," (Investment Company Institute, Investment Company Fact Book, 2009).

2.1 Table: Investment Total Net Assets by Type (Billions of dollars YE)

Year	Mutual Funds	Closed-end	ETFs	UIT	Total
1995	$2,811	$143	$1	$73	$3,028
1996	$3,526	$147	$2	$72	$3,747
1997	$4,468	$152	$7	$85	$4,712
1998	$5,525	$156	$16	$94	$5,791
1999	$6,846	$147	$34	$92	$7,119
2000	$6,965	$143	$66	$74	$7,248
2001	$6,975	$141	$83	$49	$7,248
2002	$6,390	$159	$102	$36	$6,687
2003	$7,414	$214	$151	$36	$7,815
2004	$8,107	$254	$228	$37	$8,626
2005	$8,905	$277	$301	$41	$9,524
2006	$10,397	$298	$423	$50	$11,167
2007	$12,000	$313	$608	$53	$12,974
2008	$9,601	$188	$531	$29	$10,349

*(Investment Company Institute, Investment Company Fact Book, 2009).

Who holds these assets is important to understand when determining the role of knowledge and investor attributes. Assets can be held by individual investors via specific stock ownership, through investment firms and their underlying products or by companies that invest in themselves or other companies. According to the Investment Company Institute, Investment Company Fact Book, 2009: "Households are the largest group of investors in funds, and registered investment companies managed 19 percent of households' financial assets at year-end 2008. This share is down from 2007, reflecting the drop in the value of stocks held in equity and hybrid funds. Nevertheless, the share of household assets held in funds remained above levels seen in the early 1990s. As households have increased their reliance on funds, their demand for directly held stocks and bonds has grown more slowly. For example, over the period 2004 to 2008, households purchased, on net, a total of $2.4 trillion in mutual funds (including through variable annuities), ETFs, and closed-end funds, while they sold $2.5 trillion of directly held stock. Much of this shift by households toward funds has been through net purchases of mutual funds."

This information is critical to understand the increasing reliance of American investors on investment firms and investment professionals. This data indicates that individual investors are increasing their reliance on investment firms while decreasing their desire to purchase individual stocks and bonds. Presumably, the purchase of individual stocks and bonds would require more research and risk taken on by the individual investors instead of investing in a mutual fund that pools the resources of a large number of investors and is directed by a fund manager and a research team. Choosing to rely on a fund manager instead of looking to invest themselves, indicates that individual investors may not be interested in taking on the amount of research required to effectively pick stocks or even a lack of willingness to learn what investment terms mean or how trades are made. The shift to relying on fund managers shows a willingness to trust a third party with their investment while still showing that the individual investor may still prefer to remain some control over their investments by way of choosing which mutual fund company to employ and which fund or fund manager to invest with.

2.3 Investor Decision Making

The figures discussed so far show us that the amount of money invested into markets by Americans is substantial and they are increasingly relying on financial professionals such as mutual funds mangers to invest their money for them. Handing over the decisions of how to specifically invest your money would seemingly reduce the need for additional knowledge concerning investment products, what is offered, or how they work. It would be a natural assumption, and likely one of many American investors, that a financial professional has a better knowledge of the market's inner workings and therefore their chance for success is greater than that of the average investor. What this position fails to take into account is the variety of investment products and professionals available in the American market place and the large scope of differences that exist among them. Although the investor in a mutual fund may not make the ultimate decision about which securities are purchased, there are a wide variety of funds available with different focuses, risks, expenses and tax benefits. Financial professionals would ideally present an investor with all the options available to them and an unbiased opinion of what would be best, but under the current system, financial advisors are encouraged and instructed to focus on their company's products. This is evident in the work by Xinge Zhao (2006) who found that load funds with higher 12b-1 fees receive higher inflows of new cash than no-load funds with lower expenses. 12b-1 fees are regularly paid to financial advisors as compensation. Load funds provide stronger incentives for brokers to sell them and the advisors exercise a substantial degree of influence on investments into load funds. This finding, coupled with Zhao's additional findings that an investor's competence is a good indicator if they will choose to invest in the higher cost load funds or the cheaper no-load funds. The relatively uninformed load fund investors seldom choose load funds on their own; in reality, to a significant degree, brokers and financial advisors sell the funds to these investors instead (Zhao). Not part of the process however is education by the financial advisor as investors are still left unsure of what they are investing in, and subsequently, what it costs them and how the investment works. Eighty-three percent of investors who seek advice from commission-based advisors do not know whether they own an equity or fixed-income fund (Capon et al.).

Even in the case of independent advisors that claim no affiliation with any one specific company, it can easily be argued that various commissions on different products can lead an advisor to recommend one product over another. These factors make it imperative for individual investors to understand the products they are purchasing and how it may impact their return on investment. The question for this study, however, would be if an increase in investor knowledge would lead to an increase in money invested. This point takes us to looking at a more broad based view of the service relationship and not just in terms of financial services, but looking at how the relationship is affected by various factors in the process. In establishing a relationship with a client, a service provider looks to build a high trust relationship so that additional products can be sold. Where companies are failing is in achieving a relationship with the consumer because of the inability to stimulate emotional linkages (Johnson and Grayson 2005). Emotional links can be built between service provider and client through a variety of means, often this can be done in the service delivery or in the service recovery process. In terms of financial services firms and financial advisors, one additional area could potentially be in are the area of education. Service provider expertise and product performance are antecedents of cognitive but not affective trust, and sales effectiveness is a consequence of cognitive trust but not affective trust (Johnson et al.). This would lead us to wonder how a financial firm can strengthen the important emotional bond, something that is more difficult to break. A client that is only bonded to one financial service firm because of that firms perceived expertise, can easily be swayed to another firm should the expertise seem greater. However, an emotional bond is more difficult to emulate and thus more difficult to break. Affective trust contributes significantly to a customer's willingness to meet with the service provider in the future, affective trust has only a modest impact on financial service relationships (Johnson et al.). It is in this area of lack of affective trust that a continuing knowledge transfer between financial advisor and client could build the affective trust and emotional bond. It would appear most beneficial to build an ongoing relationship by increasing knowledge by the investor while also delivering quality service and product performance.

One final point to consider when discussing investor decision-making is an element that is present in all service related companies, but could potentially be even greater for financial firms, and that is the perceived risks in purchasing and using services. Lovelock and Wirtz (2007) identify the following risks for service consumers:

- Functional-unsatisfactory performance outcomes
- Financial-monetary loss, unexpected loss
- Temporal-wasting time, consequences of delays
- Physical-personal injury or damage to possessions
- Psychological-personal fears and emotions
- Social-how others think and react
- Sensory-unwanted effects on any of the five senses

The most obvious perceived risks that are nearly always present when investment firms attempt to sell their services are the first two listed; functional and financial. In the investment arena these two go hand in hand as monetary loss is almost always directly related to unsatisfactory performance. The difficulty in the service delivery is that the performance is always unpredictable and in fact strict regulation keeps firms from promising service (i.e. investment) performance. However, when trying to avoid this service delivery from investment firms, investors face different risks. Individual investors who hold common stocks directly pay a tremendous performance penalty for active trading (Barber and Odean 2000). Barber et al. studied 66,465 households with accounts at a large discount broker during 1991 to

1996. The most active traders earned an annual return of 11.4 percent, while the market returned17.9 percent. This type of disparity leaves an individual investor in the difficult position of either accepting a service delivery that his highly unpredictable, or attempting to do it yourself and face the potential pitfall associated with lack of investor knowledge.

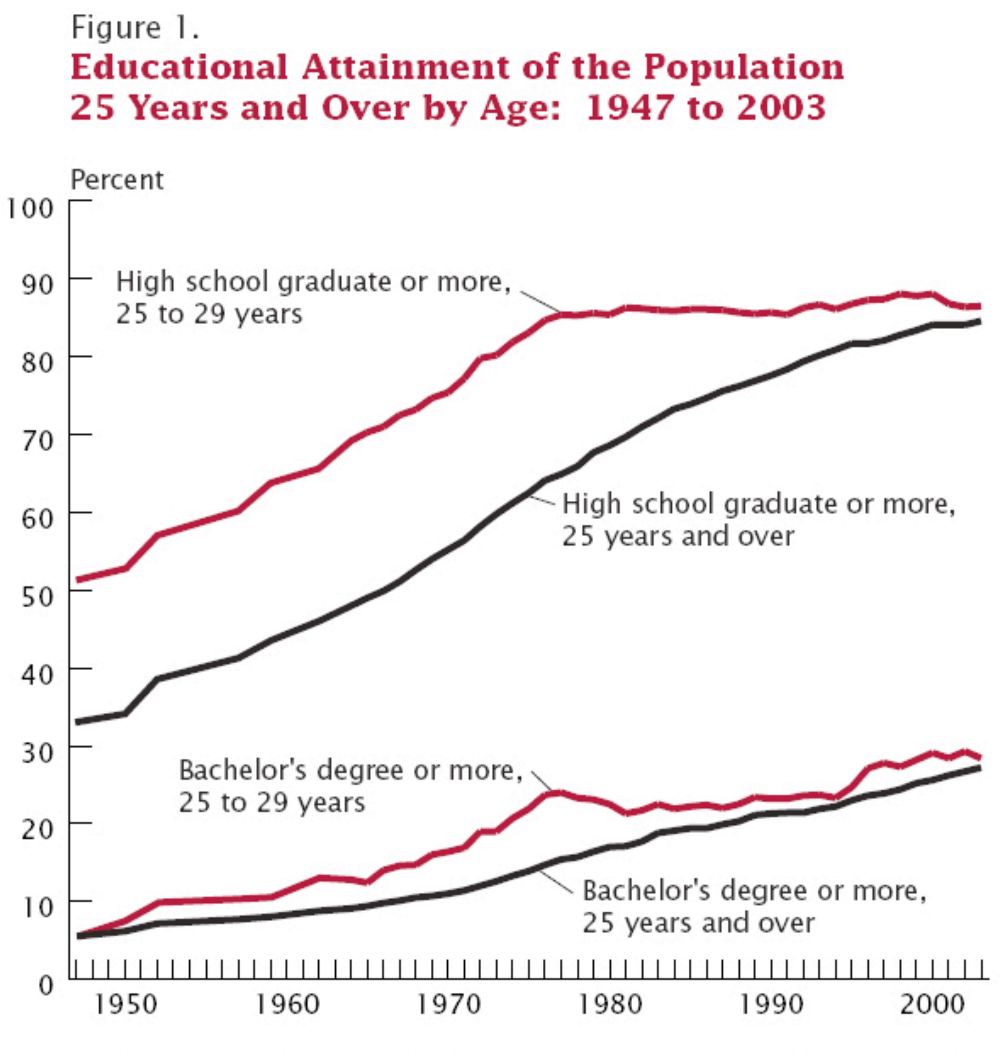
2.4 Current Education Level

Since the study looks at the idea of increasing the knowledge level of the current investor, it is important to take a cursory review of the current education levels attained in the United States. This review is not specific to knowledge of investments or investment products, but instead a broad based review of the education level in America. This is important because we first need to understand what the education level is like and if the population would even be receptive to additional education. To be more specific, if a country's population generally lacks an overall quality education, than trying to raise the education level in one specific area such as investments, would likely prove futile. You could not take a general population that has few college graduates and a large portion of people who did not graduate high school, and attempt to educate them in the world of stocks, bonds, mutual funds, annuities etc. It is important to determine if there is a good base of education in which to build the knowledge related to investment offerings. Without a good base in which to continue and build an education the investment knowledge would simply be lost. A study looking at the effects of increasing knowledge would be insignificant because there would be no point in researching the effects of increased knowledge on a given population when the proposed increase in knowledge is beyond the realm of understanding of a large portion of the population.

Therefore a cursory review of the current state of education in the United States is important to at least attain the capacity for the general public to become more educated about a relatively complex issue such as investments. In generalities, the United States is generally viewed as a well-educated public in relation to other industrialized nation. It is similar in that the majority of the population has completed secondary education and the literacy rate for the country is at 98 percent of the population over the age of 15 (U.S. Department of Education). The amount of education received by the population of the United States has continued to rise as 86.6 percent of the population over 25 have at least completed high school and 29.4 having completed at least a bachelor's degree in 2008. This is an increase from 84.1 percent and 25.6 respectively from 2000 (U.S. Department of Education). The United States education system is not however without its downfalls as the education level of its citizens is below average in science and mathematics compared to other developed countries. In the Third International Mathematics and Science Study of comparative mathematics achievement in forty-odd countries, U.S. students demonstrated adequate to poor mathematics achievement (Howe 1999). In addition to the comparatively lower educational level in science and mathematics, racial lines are also clearly drawn in the United States with the minority populations having a lower education level than those of their white counterparts. For example, in the areas of high school completion, African Americans had an 83.3 percent completion rate and 19.7 had achieved at least a bachelor's degree. (U.S.

Department of Education). So although there are certainly shortcomings in the United States education system, it is believed that these statistics establish that there is at the very least a foundation of generally well educated adults of which would have the capacity to engage in general understanding of the investment market and the potential offerings that may be available to them.

Table 2.2 Educational Attainment



Note: Prior to 1964, data are shown for 1947, 1950, 1952, 1957, 1959, and 1962.
Source: U.S. Census Bureau, Current Population Survey and the 1950 Census of of Population.

2.5 Education of Current Investors

In addition to simply looking at the overall characteristics of the general education level of adults in the United States, it would also be helpful to review some of the characteristics, education and otherwise, of current investors. This group represents people who obviously have some experience in the world of investments but may choose to let their investment choices be guided by an investment professional or may only have a cursory knowledge of their current investments or exactly what is available to them. Looking at the education level of this group is important because they represent investors whom have shown an interest in participating in one of the various investment markets and likely have additional funds that could be invested or are currently investing at regular intervals through a work orientated retirement plan.

The Investor Knowledge Survey: A Report of the Findings, which was commissioned by the Investor Protection Trust (IPT) and conducted by Princeton Survey Research Associates during January 1996, found that fewer than one-fifth of all individual investors (in stocks, bonds, funds, or other securities) could be considered to be “financially literate” based on responses to a quiz (Alexander, Jones and Nigro 1995). This finding shows that even though somebody may be a current investor, that is not an indicator of their financial knowledge. While they may rely on the market to provide them the returns they need to fund their retirement or children’s education, seeming important things to the lives of many American families, their knowledge of how their investment work or could be working is limited. A survey released in early 1994 by the American Association of Retired Persons stated that "the vast majority of American bank consumers are unaware of the risks and fees involved in the sale of uninsured investment products, such as mutual funds and annuities, that are increasingly available at U.S. banks and other financial institutions" (Alexander et al.). With this information it can be ascertained that even though people may have some of their assets currently invested in products exposed to the stock market through various investment vehicles offered by banks, they have little knowledge of how the investment products work. Most importantly these investors have little knowledge of two of the most important factors in reviewing your investment choices; the potential risk and the expenses related to your choice of investments. These two factors alone can have a substantial impact on the returns you are likely to experience and without the knowledge of the current risks or expenses it would be seemingly impossible to form a strong and educated opinion about your investment choices. Further review of this information can also lead to a reasonable conclusion that since the respondents have such little knowledge about their current investments, they must have entrusted the allocation of their resources by accepting the general advice of the investment professional which sold them the investment vehicles they now own, but know little about. This further shows that there is a strong need for additional education concerning the investment products available to both potential and current investors.

In addition to the above findings we can also examine the following. A study in 1994 argues that a substantial number of bank mutual fund purchasers believe their mutual fund investments are insured by the federal government (American Association for Retired Persons-AARP 1994). The federal government makes no such promises and in fact only backs deposits in FDIC banks, and even that amount is limited in dollars. Like all assets invested in the market, these investments, although sold by banks, can be lost entirely in a very short amount of time. The fact that these investors believe their investments are safe and secure because of the institution that sold them the investment products shows the depth of the problems that can persist with a lack of knowledge.

Several logical conclusions can be derived from this information, not the least of which is that once again it is shown that even though investors have purchased a product exposed to the volatile nature of the market, they have little understanding as to what they have purchased. This particular piece of information is even more alarming in that it was conducted by the AARP which by nature has in its membership people which are looking to sustain their current lifestyle by their investment choices. These investors have seemingly spent a lifetime accumulating these assets without actually understanding how they have entrusted their nest egg that they presumably will need to sustain their current lifestyle. In this particular instance we have maybe the most alarming group of uninformed investors, those that have substantial assets that are needed to sustain themselves financially. Additionally, this group has retired and therefore seemingly has little way to replace the assets that may be lost due to the volatility of the market. As the population of American, like most industrialized nations, grows older with the continued aging of the Baby Boom Generation, the amount of assets available to be invested will only continue to increase, but as we can see from the above information, that doesn’t necessarily mean that they will be any more knowledgeable about how to invest their assets.

It can certainly be debated where this general lack of knowledge about some of the basic workings of popular financial products derives from, either by an apathetic interest by the general public or by information disseminated by financial firms would be two possible areas. But in looking at the education level of the investors we can see that there is ample opportunity to be further educated about investments and gain a proper understanding of how the products work. Mutual fund investors are well educated, with 54.6 percent having completed college, compared with 39.4 percent of the U.S. voting-age population (Alexander et al.).

Delving further into this information sheds some additional light on the situation facing investment companies trying to educate investors: College graduates are significantly more likely to believe one can lose money in a stock fund; knowledge that bond funds can lose money is related to age (older investors are more likely to know), income (wealthier investors are more likely to know), and gender (males are more likely to know); and respondents younger than 35 are less likely to believe that one can lose money in a money market fund. (Alexander et al.). Even with substantial knowledge of how their investment products work, investor do not always make the correct choices. Daniels, Hirshleifer and Subrahmanyam (1998) developed a theory based on investor overconfidence and reliance on self-attribution. The theory stated that investors overreact to private information signals and under react to public ones. This information says that based on various characteristics, investor knowledge changes. It also gives a base to begin an education process that is dependent on whom the target market is and what product is being. Despite the difference in characteristics and education levels, these statistics tells us that there is room for growth in the area of investor knowledge.

2.6 How Investors Choose to Invest

Next it is important to look at a study that closely reviewed the psychology of investors and what makes them choose to invest. In their article "Social Interaction and Stock Market Participation" Hong, Kubik and Stein (2004) reviewed what impact an investor's social interactions has on their decision to invest. They begin their research by citing previous studies that show participation in the market can have a direct impact on the premium paid for securities. This is a simple supply and demand issue. As more people enter the market, the price of securities is driven upwards as there are fewer securities available for each investor. This theory is outside the other factors that have been discussed to affect the price of securities such as revenue, profits, dividends and long-term sustainability. The authors also review the impact that wealth and education have on an investor's interest in participating in the market. It was determined that both influence the participation of the investor as wealth makes it easier to absorb the costs associated with investing and education also increases participation as the cost is lowered because investors are able to invest independently of the costly obstacles attached with financial professionals. Aside from the education and wealth aspects, Hong reviews what impact social interaction has on somebody's intent to participate in the stock market.

What Hong found was that social interaction impacts an investor's willingness to participate in the market. A more sociable household is more likely to enter into the stock market than a household that generally keeps to themselves. Hong believes there are two factors at work here, first is the word of mouth information sharing among investors or potential investors, meaning that increased knowledge among investors will increase one's participation in the market. Word of mouth knowledge sharing can lead to an increase in knowledge about various securities and influence one's interest in investing. The other factor Hong discusses is the enjoyment people get from social interaction and discussing the market. The conclusion is that since people enjoy discussing the market with each other they will be more likely to invest and face less apprehension in doing so.

Hong's work is significant in the scope of this paper in that both factors that Hong discussed are ultimately an increase in investor education. Although the education is not formerly through the investment firms which service these potential investors, but instead, informally through their social interaction. Although the means of the education studied by Hong is different than that which is the scope of this research, it is nonetheless an increase in education. Social interaction education is certainly a strong factor in influencing one's behavior, but the education received is not always correct or accurate. So instead of reviewing the increase in education received by social interaction, this research looks at the effect an increase in education by investment firms through their marketing would have on increasing investor's participation. Further research could even potentially combine the two and review investor education and social interaction in the scope of education being conducted through marketing and the influence that has on one's social interaction when discussing the education they have received. At this time, this is outside the scope of this study.

Also looking at how investors choose to invest we have to look at the emotional aspects that investors undergo when making investment choices. One of the more interesting studies looking at emotion and investing actually went to the center of emotion, the brain. In looking at patients that had brain lesions, some in the area associated with emotion and others without, researchers found that those patients that suffered from lesions in the emotional areas of the brains made more advantageous decisions and earned more money (Shiv, Loewenstein, Bechara, Damasio, Damasio 2004). This outcome was because when the patients without lesions won or lost money they became more conservative, however, those with lesions in their emotional areas continued to invest and subsequently were able to receive more attractive returns. This study would indicate that a lack of emotion would benefit investors and therefore lead to more success if the investor was able to separate emotion from the investment process and rely more on an intellectual perspective. Most theoretical models of risk taking assume that risky decision-making is largely a cognitive process of integrating the desirability of different possible outcomes with their probabilities (Shiv et al.). Other research disagrees with this idea however.

Using emotion in the investment decision-making process is actually helpful and can increase performance. Emotion differentiation and affective influence are essential process of components of emotional intelligence that positively influence individual performance outcomes (Seo and Barrett 2007). Seo and Barrett did internet based stock investment simulation to study how affective experience impacts decision making. What they found was how beneficial or harmful emotions were to investing depended on how people experience, treat or use their feelings. An alternative approach in which both functional and dysfunctional effects of feeling are equally acknowledged and simultaneously managed to maximize their positive effects and minimize their negative effects (Seo et al.). This finding is similar to work done by Shefrin (2000) who says that it is this actual control of emotions that makes some investors so successful. Shefrin points to value investors as perfect examples. Value investors look for stocks not necessarily based on the highest profits or revenue, but based instead on the current value of the stock. There may be stocks that offer greater profits or better financial ratios, but their price may already have reached its peak or may be overinflated. Value investors only succeed if they are able to put aside the emotion of going for the biggest names with the biggest profits and actually look for companies that may be suffering currently but have potential in the future. In short, value investors are contrarian looking for stocks other people are selling and looking to but them at a deep discount. On its face, this method requires effective control over emotions argues Shefrin. Using this type of investment strategy may be difficult for inexperienced investors. Inexperienced investors are more confident that they will beat the market than are experienced investors. Investors search only for confirming evidence; they ignore disconfirming evidence (Shefrin).

Trading solely on emotion can also have a negative effect however. Emotional traders may trade because they mistakenly believe they are trading on information or perhaps because they simply like to trade (Ackert, Church and Deaves 2003). The work of Ackert et al. suggest that although emotion has important influences on financial behavior, it does not contaminate judgment. Emotion is an important aspect of the human condition that can actually enhance decision making (Ackert et al.).

What this review of emotion on investing tells us then is that emotion is not necessarily bad when it comes to making investment choices, but it does need to be applied correctly along with quality information. If investors rely on emotion alone or act in the absence of emotion they may not experience the maximum return. When comparing these findings with the idea of investor knowledge, we see that emotion is one more area where investors need to increase their knowledge to use emotion correctly. An investors needs to accurately understand their current investment knowledge and how that can effectively be put to use when making investment choices. Investing sans emotion can also be a negative and investors must use knowledge about their emotions to be their most effective.

2.7 Current Economic Challenges

Before moving on to other aspects of the potential research it is important to briefly touch on the current economic challenges facing the United States and the world. Although not something examined in this study, it is important to realize that investors are far more likely to ask questions about their investments during times of negative returns than during times of positive returns. Certainly a financial free fall like that which was experienced in 2008 has left many investors wondering exactly what they were invested in. It may also have an impact on the individual investors strategy more than it would for a financial professional. Unlike institutional investors, individual investors prefer stocks with lottery-type features. The demand for lottery-type stocks increases during bad economic times and demand shifts influence the returns and volatility of those stocks (Kumar 2005).

Not to be ignored either are the financial scandals that shook much of the financial world and left so called “savvy” investors with little knowledge of exactly what they were invested in. Since the economic crisis is outwith this study, it may seem insignificant. However, what is crucial to point out is that when investor confidence is shaken, as surely happened with the historical drops of investment returns, investors will begin to have more questions. This response is natural as investors become aware that they may not have fully understood what they were invested in and what the potential downfalls could be. Those investor’s who felt they were unable to lose money in a mutual fund or those that felt the United States government would guarantee their investment, have likely learned that is not the case. This is important in the scope of this study because the current situation provides a great opportunity for investment companies to educate the public. This education could be not only related to the investment firm’s products, but the market workings as well. There is little better time to teach these factors than after a drop in prices, and there has not been such a substantial drop in prices in many years. So the link between investor knowledge and investment barriers indicate an area that investment firms could exploit to expand this assets under management.