Women & Wealth: More than men, women want to understand the risks they're taking

There's a common belief that women are more risk-averse than men.

We polled several wealth advisors on this topic and provide here their collective observations along with some supporting research. Their conclusion? In reality, women may be more risk-aware . . . not more risk-averse. A subtle, yet important difference. Women are more likely to ask probing questions about the risk implications of portfolio choices but don't necessarily shy away from taking on risk when appropriate.

Risk tolerance is critical for long-term financial success

Before any investment plan is established, one must clearly understand their true tolerance for risk.

But what about at a broader level? Is there actually a clear connection between gender and financial risk tolerance?

If there is, there's reason to be concerned about the average woman's investment earnings potential, because the only way to increase long-term returns above a "safe" but low level— such as the returns provided by U.S. Treasury notes—is to take on risk.

Many women are willing to accept a level of risk appropriate to their individual circumstances and goals. However, where they differ from men is in their desire to understand those risks at a deeper level. That's a clear positive, because investors who understand the what, why AND how of their portfolio positioning are more likely to stay with an investment program through challenging markets. That staying power tends to correlate with long-term investment success.[1]

Recent research calls into question so-called gender differences in risk tolerance

Academic research is increasingly identifying specific factors that appear to affect risk tolerance in both women and men. These factors help decompose what may otherwise appear as broad gender differences in risk tolerance.

For example, one recent study deconstructs the conventional view that women are less risk-tolerant than men:

"Gender differences do not result from gender in and of itself. Individual variables that moderate the relationship between gender and high risk tolerance are income uncertainty and net worth, with income uncertainty moderating the relationship between gender and some risk tolerance."[2]

As the study notes, the average woman has lower and more uncertain financial resources than the average man. So, at a broad societal level, it's the aggregation of those individual differences in resources and expectations—and not anything inherent about gender—that drive risk tolerance.

[1] *Gary Charness, Ph.D. (University of California in Santa Barbara) and Uri Gneezy, Ph.D. (University of California San Diego). "Strong Evidence for Gender Differences in Risk Taking." https://pdfs.semanticscholar.org/0d86/4e43d6c13c0cd4e20cd8c115b893a78d67a4.pdf*

[2] *Patti J. Fisher, Ph.D. (Virginia Tech) and Rui Yao, Ph.D. (University of Missouri). "Gender Differences in Financial Risk Tolerance." https://vtechworks.lib.vt.edu/bitstream/handle/10919/88523/SSRN%20Gender%20Risk%20Tolerance%209-21-17.pdf?sequence=2&isAllowed=y*

Women make financial-risk decisions based on their actual financial knowledge—

Another study looks at the importance of education as part of an investment program.

Researchers found that investment decision-making is "strongly associated with both actual and perceived financial literacy for men, but only with actual literacy for women."[4]

Women are more likely to ask probing questions about the risk implications of portfolio choices. But it may also be true that if women don't understand an investment program, they are less likely than men to take action.

This desire to understand—to engage with risk in a well-informed way—is highly supportive of long-term success, because it can correlate to staying invested through volatile periods.[5]

Not taking action can, in some cases, be worse than taking less-informed action (presuming a trusted advisor is in place to guide any action that is taken). For example, an investor—whether woman or man—who keeps a disproportionately large fraction of total assets in cash because of an unfounded fear of risk could miss out on a period of positive performance in the markets, thus winding up with a lower rate of return than an investor who invests in a basic investment program (e.g. 60% equity/40% fixed income allocation) for the same period of time.

Women and risk—beyond investment decision-making

Academic research tends to emphasize that:

1. Men are more likely to perceive less risk than women; and
2. Men are more likely to take more risk than women

But consider this: both of these almost stereotypical points might fall apart if broadening what's meant by "risk" in the first place. We think it may be helpful to many women, as they think about their own risk tolerances, to remember that for the most part society talks about risk in financial and physical terms.

Leadership and strategy consultant and researcher David Sundheim addresses the issue this way in a contribution to the Harvard Business Journal:

> *"Do women take as many risks as men?" I think they do. The trouble is that historically risk-taking has been framed so narrowly that it skews our perceptions. For example, the majority of studies that point to men having a greater inclination for risk-taking define risk in physical and financial terms. They don't point to risks like standing up for what's right in the face of opposition, or taking the ethical path when there's pressure to stray — important risks that I've found women are particularly strong at taking. If these sorts of risks were fully accounted for in our business culture, would it balance the gender perception? I think it would* [3].

To us, this rings true. While it's possible there is some biological difference, on average, in how women and men process risk in certain contexts, that doesn't mean women don't engage with risk. And in our view, that's essential not just for women's own financial futures but for society as a whole. That's true with respect to philanthropy, business and every other context. As Melinda Gates of the Bill and Melinda Gates Foundation has emphasized recently, data indicates that when capital is in the hands of women, good things tend to occur.

[3] https://hbr.org/2013/02/do-women-take-as-many-risks-as

[4] *Christina E. Bannier, Milena Neubert (Gutenberg University Mainz). "Gender differences in financial risk taking: The role of financial literacy and risk tolerance." (2012)* https://fardapaper.ir/mohavaha/uploads/2018/02/Fardapaper-Gender-differences-in-financial-risk-taking-The-role-of-financial-literacy-and-risk-tolerance.pdf

[5] *Gary Charness, Ph.D. (University of California in Santa Barbara) and Uri Gneezy, Ph.D. (University of California San Diego). "Strong Evidence for Gender Differences in Risk Taking."* https://pdfs.semanticscholar.org/0d86/4e43d6c13c0cd4e20cd8c115b893a78d67a4.pdf

Given the inclination of women to seek understanding, it's important to ensure that the quest for knowledge doesn't turn into paralysis when it comes to allocating investments! This is one of many reasons why education is a key element of the advisor-client relationship. Education and understanding can instill confidence so that decisions can be timely, anchored to individual objectives.

Portfolio risks and risk management

What is risk, generally? Risk is the exposure to the chance of injury or loss . Risk usually gets confused with definitions of peril and hazard. Peril is the exposure to injury or loss and hazard is an unavoidable danger . A differentiation between these definitions is key when learning about risk.

In an investment portfolio, the definition of risk becomes nuanced. Below are types of risk present in any investment portfolio:

» Market risk—the risk that an asset's price may fall in concert with the broader market

» Inflation risk—the risk of asset-value erosion as price levels rise

» Liquidity risk—the risk that an asset may not be readily convertible to cash at a desirable price

» Political risk—the risk that "macro" factors unrelated to asset-specific fundamentals will affect asset values

» Foreign-exchange risk—the risk that currency-value changes will negatively affect an asset's value in a "home" currency

In each of these cases, a particular influencing factor may be either short-term or long-term—and it's often impossible to know which will prove to be the case. For example, consider market risk. During the fourth quarter of 2018, some U.S. stock-market indices dropped about 20% in value—brushing up against the common definition of a bear market. However, that correction was short-lived, with the same indices recovering most of their value in the first quarter of 2019 and then going on to record-high levels in the first half of the second quarter.

Of course, it wasn't possible for investors to know that market prices would recover. Some undoubtedly sold out of stocks during the fourth quarter of 2019, perhaps fearing a return to painful bear-market conditions ten years prior.

Many who did step away in fear of market risks likely failed to reenter the market as it began its upward swing earlier in 2019. That is why understanding risk and being risk-aware – an attribute of many women investors --, is essential for investing wisely, whether male OR female.

Decision-making based on fear is understandable but not optimal. To avoid emotional responses to risk factors, it's critical to have in place a disciplined risk-management program that includes, a periodic review of asset allocations in relation to objectives. Having continued conversations with your financial advisor about your goals and objectives will result in greater confidence and understanding regarding risk.

Conclusion

Long-term investment success requires a willingness to take on risk. In our experience, women both recognize this and are perfectly willing to engage with risk, so long as they are confident about doing so wisely.

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