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An investigation of the impact of financial literacy, risk attitude, and saving motives on the attenuation of mutual fund investors' disposition bias

Abstract

Purpose – The purpose of this paper is to investigate the impact of financial literacy, risk attitude, and saving motives on the attenuation of mutual fund investors' disposition bias. Specifically we focus on individual characteristics explaining investors' propensity to sell shares in a poorly performing mutual fund.
Design/Methodology/Approach – The study relies on survey data collected from 1,564 Swedish households in 2013. We test our hypotheses considering three different portfolio compositions and portfolio performances. Each composition corresponds to a dependent variable and a separate model which are estimated using ordinal logistic regression.
Findings - We find that different forms of financial literacy affect attenuation of the disposition effect. Specifically, we find that knowledge about mutual funds and knowledge about current market conditions affect the attenuation of the disposition effect, whereas we find no support for the effect of "technical financial knowledge" (e.g., ability to calculate compound interest rates). We also find no support for the effects of risk attitude and saving motives on the attenuation of the disposition bias.
Originality/Value- Findings suggest a need for a more fine-grained conceptualization of the financial literacy concept and its effect on investors' disposition bias. Since an important implication of the findings is that financial literacy could potentially help people overcome behavioral bias, the study also provides insights for policy makers as well as into the discussion on design of consumer education programs.

Keywords Mutual fund investors; Disposition effect; Financial literacy; Risk attitude; Saving motives
Paper type Research paper

1. Introduction

Public interest in the mutual fund industry has grown rapidly during the past few decades, and the supply of funds has grown extensively (Coates and Hubbard, 2007). Researchers investigating mutual fund investments have concluded that fund inflows to well-performing funds are much greater than fund outflows from poorly performing funds (Sirri and Tufano, 1998). This behavior could be explained by the disposition effect. The disposition effect refers to the tendency of investors to sell winning stocks too early and holding on to losing stocks for too long (Shefrin and Statman, 1985; Odean, 1998; Shapira and Venezia, 2001). The principal explanation for the disposition effect is based on Kahneman and Tversky's (1979) prospect theory, according to which gains and losses are often judged relative to a reference point and individuals exhibit risk-averse behavior for gains and risk-seeking behavior for losses.

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