

Universität Mannheim
Lehrstuhl für Internationale Finanzierung
68131 Mannheim

Besucheradresse:

L9, 1-2
68161 Mannheim
Telefon 0621/181-3755
Telefax 0621/181-1664

Michael Ungeheuer
ungeheuer@bwl.uni-mannheim.de
<http://intfin.bwl.uni-mannheim.de>

Seminar HWS 2013: "Household Finance"

- TOPIC R1: Financial Advice, Individual Investors, and Mutual Fund Selection**
Advisor: Nic Schaub
- TOPIC R2: Financial Advice, Individual Investors, and Mutual Fund Performance**
Advisor: Nic Schaub
- TOPIC R3: Financial Advice, Individual Investors, and Structured Products**
Advisor: Nic Schaub
- TOPIC R4: Performance-Chasing Around Market Downturns**
Advisor: Michael Ungeheuer
- TOPIC R5: Momentum Crashes and Flow-Induced Mutual Fund Trading**
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- TOPIC R6: Predictable Fund-Flows and the Cross-Section of Stock Returns**
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- TOPIC R7: Determinants of Financial Literacy**
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Advisor: Lena Jaroszek



TOPIC R1: Financial Advice, Individual Investors, and Mutual Fund Selection

Classification: Empirical topic

Advisor: Nic Schaub

A majority of individual investors relies on financial advice when investing in stocks, bonds, or mutual funds. However, still only little is known about the influence of financial advisors on their clients' portfolio composition and performance. This study focuses on the relation between financial advice and individual investors' mutual fund selection. The goal of this study is to provide an overview of the existing literature on the influence of financial advice on investors' portfolios, especially on mutual fund holdings. In an empirical analysis, differences in characteristics of mutual funds (e.g., fees, fund manager, investment area) recommended by financial advisors and mutual funds picked independently should be investigated. Data on financial advice and mutual fund trading of individual investors will be provided. Mutual fund characteristics are available via the Morningstar database.

Introductory Literature:

Bergstresser, D., Chalmers, J., Tufano, P., 2009, Assessing the costs and benefits of brokers in the mutual fund industry, *Review of Financial Studies* 22, 4129-4156.

Hackethal, A., Haliassos, M., Jappelli, T., 2012, Financial advisors: A case of babysitters?, *Journal of Banking and Finance* 36, 509-524.

Kramer, M.M., 2012, Financial advice and individual investor portfolio performance, *Financial Management* 41, 395-428.

TOPIC R2: Financial Advice, Individual Investors, and Mutual Fund Performance

Classification: Empirical topic

Advisor: Nic Schaub

A majority of individual investors relies on financial advice when investing in stocks, bonds, or mutual funds. However, still only little is known about the influence of financial advisors on their clients' portfolio composition and performance. This study focuses on the relation between financial advice and the performance of mutual funds traded by individual investors. The goal of this study is to provide an overview of the existing literature on the influence of financial advice on investors' portfolios, especially on mutual fund performance. In an empirical analysis, the performance of mutual funds recommended by financial advisors should be compared to the performance of independently chosen funds. Data on financial advice and mutual fund trading of individual investors will be provided. Data on mutual fund performance is available via the Morningstar databases and the Datastream database.

Introductory Literature:

Bergstresser, D., Chalmers, J., Tufano, P., 2009, Assessing the costs and benefits of brokers in the mutual fund industry, *Review of Financial Studies* 22, 4129-4156.

Hackethal, A., Haliassos, M., Jappelli, T., 2012, Financial advisors: A case of babysitters?, *Journal of Banking and Finance* 36, 509-524.

Kramer, M.M., 2012, Financial advice and individual investor portfolio performance, *Financial Management* 41, 395-428.

TOPIC R3: Financial Advice, Individual Investors, and Structured Products

Classification: Empirical topic

Advisor: Nic Schaub

Structured products are financial derivatives whose payoff at maturity depends on one or more classical assets, mostly stocks or stock indices. Most of them are issued by banks and targeted to individual investors which can be seen from the fact that they are, for instance, advertised in newspapers. Structured products have gained substantial popularity in recent years with individual investors. Little is known about the role of financial advisors in selling these products. This study focuses on the relation between financial advice and individual investors' structured product selection. The goal of this study is to provide an overview of the existing literature on individual investors and structured products. In an empirical analysis, differences in characteristics of structured products (e.g., category, issuer, underlying) recommended by financial advisors and structured products picked independently should be investigated. Data on financial advice and structured products trading of individual investors as well as data on structured product characteristics will be provided.

Introductory Literature:

Hackethal, A., Haliassos, M., Jappelli, T., 2012, Financial advisors: A case of babysitters?, *Journal of Banking and Finance* 36, 509-524.

Henderson, B.J., Pearson, N.D., 2010, The dark side of financial innovation: A case study of the pricing of a retail financial product, *Journal of Financial Economics* 100, 227-247.

Hens, T., Rieger, M.O., 2011, Why do investors buy structured products?, Working Paper, University of Zurich.

TOPIC R4: Performance-Chasing Around Market Crashes

Classification: Empirical topic

Advisor: Michael Ungeheuer

The flows into and out of equity mutual funds are known to be predictable by past fund performance. Particularly, fund investors buy funds, which performed well, whereas they do not react as strongly to past bad performance, i.e. the performance-flow relationship is convex (Sirri/Tufano, 1998). Fittingly, on the aggregate level, a positive relationship between market performance and fund flows can be observed. These empirical results hold for unspecified market conditions. The task for this seminar thesis is the analysis of the performance-flow relationship during and around market crashes.

Why is the link between past performance and flows particularly important during market crashes? Flow-induced asset sales cause liquidity costs if outflows are systematic, e.g. after a market downturn. These liquidity costs lower fund returns (Coval/Stafford, 2007). Thus fund managers have an interest in forecasting and preparing for outflows, particularly around market crashes. U.S. Fund data will be provided.

Introductory Literature:

Sirri, E.R., Tufano, R., 1998, Costly Search and Mutual Fund Flow, *Journal of Finance* 53, 1589-1622.

Berk, J.B., Green, R.C., 2004, Mutual Fund Flows and Performance in Rational Markets, *Journal of Political Economy* 112, 1269-1295.

Coval, J., Stafford, E., 2007, Asset Fire Sales (and Purchases) in Equity Markets, *Journal of Financial Economics* 86, 479-512.

TOPIC R5: Momentum Crashes and Flow-Induced Mutual Fund Trading

Classification: Empirical topic

Advisor: Michael Ungeheuer

The momentum strategy – buying past winners and selling past losers – has provided high historical returns in stock markets of many countries. However, Daniel and Moskowitz (2013) find that occasionally this strategy ‘crashes’. These crashes happen after bear markets, defined as 2-year periods of negative market returns. Bad momentum returns are caused by very high returns on former losers, which are short-sold in the momentum strategy. Particularly, stocks that were among the losers during a bear market react asymmetrically to market returns: If the market recovers, they provide very high returns (‘have a high beta’), but if the market keeps performing badly, they perform relatively well (‘have a low beta’). The task for this seminar thesis is to analyze, whether the asymmetric relationship between loser-returns and market-returns can be explained by flow-induced trading of mutual funds.

Usually, investors tend to buy (sell) funds that performed well (badly) over the recent past. This forces fund managers to buy (sell) assets, which can lead to higher (lower) prices for these assets (Coval/Stafford, 2007 and Lou, 2012). If this relationship breaks down during recoveries after bear-markets, this could explain momentum crashes. Losing funds that hold past loser-stocks would have to attract large inflows during recovery, but no significant outflows if the market keeps performing badly. A dataset with fund data, including fund holdings, will be provided.

Introductory Literature:

Daniel, K., Moskowitz, T., 2013, Momentum Crashes, WP.

Coval, J., Stafford, E., 2007, Asset Fire Sales (and Purchases) in Equity Markets, *Journal of Financial Economics* 86, 479-512.

Lou, D. 2012, A Flow-Based Explanation for Return Predictability, *Review of Financial Studies* 25, 3457-3489.

TOPIC R6: Predictable Fund-Flows and the Cross-Section of Stock Returns

Classification: Empirical topic

Advisor: Michael Ungeheuer

Fund flows are predictable based on past flows, past fund-performance and other variables. Systematic fund flows are known to have an impact on asset prices (Coval/Stafford, 2007 and Lou, 2012): If many funds hold a security and are simultaneously forced to sell it due to outflows, then this puts downward pressure on the security's price. The task for this thesis is to analyze, whether the relative performance of certain securities (e.g. value- vs. growth stocks or small vs. big stocks) can be predicted based on expected flow-induced trading of mutual funds. For instance: If value funds are expected to have high inflows, whereas growth funds are expected to have low inflows for the next quarters, does this predict higher returns of value stocks relative to growth stocks? A dataset with fund data, including fund holdings, will be provided.

Introductory Literature:

Coval, J., Stafford, E., 2007, Asset Fire Sales (and Purchases) in Equity Markets, *Journal of Financial Economics* 86, 479-512.

Lou, D. 2012, A Flow-Based Explanation for Return Predictability, *Review of Financial Studies* 25, 3457-3489.

Frazzini, A., Lamont, O.A., 2008, Dumb Money: Mutual Fund Flows and the Cross-Section of Stock Returns, *Journal of Financial Economics* 88, 299-322.

TOPIC R7: Determinants of Financial Literacy

Classification: Empirical topic

Advisor: Lena Jaroszek

Households' understanding of financial products and the mechanisms in financial markets, i.e. their financial literacy, has been found to matter for households' financial decision making. Empirical studies of households' financial decisions reveal that low financial literacy has a negative influence on households' savings decisions and decision to participate in the stock market. However, causality can also run in the opposite direction: households active in financial markets can learn from the experience. The aim of this study is to analyze which factors influence a households' level of financial literacy. A broad set on German household data provides information on households' financial decisions as well as other households characteristics and demographics (such as gender, education or income). These data are to be examined in order to identify factors associated with different levels of financial literacy.

Introductory Literature:

Lusardi, A., and O. S. Mitchell, 2008, Planning and Financial Literacy: How Do Women Fare?, *American Economic Review*, 98(2), 413-417.

Bucher-Koenen, T., and A. Lusardi, 2011, Financial Literacy and Retirement Planning in Germany, *Journal of Pension Economics and Finance*.

TOPIC R8: German Households' Financial Decisions

Classification: Empirical topic

Advisor: Lena Jaroszek

While normative theory provides clear guidelines how private households should manage their financial matters, empirical analyses of household' financial decisions reveal strong deviations in their actual behavior. While these deviations can stem from aspects difficult to incorporate into normative theory – illiquidity of housing assets, borrowing constraints and taxation – other deviations from normative finance decisions are due to behavioral or even irrational aspects. The goal of this study is to analyze financial decisions of German households based on information provided in a comprehensive data set focusing on savings and old-age provision decisions. The emphasis should lie on identifying behaviors which deviate from what can be expected from normative theory.

Introductory Literature:

Campbell, John Y., 2006, Household Finance, Journal of Finance, 61 (4), 1553-1604.

Schunk, Daniel, 2009, What Determines the Savings Behavior of German Households? An Examination of Saving Motives and Saving Decisions, Journal of Economics and Statistics, 229, 4 (2009), 467-491.
