

# FUNDAMENTALS

MUTUAL FUND RESEARCH IN BRIEF

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## Shareholder Perceptions of Investment Risk

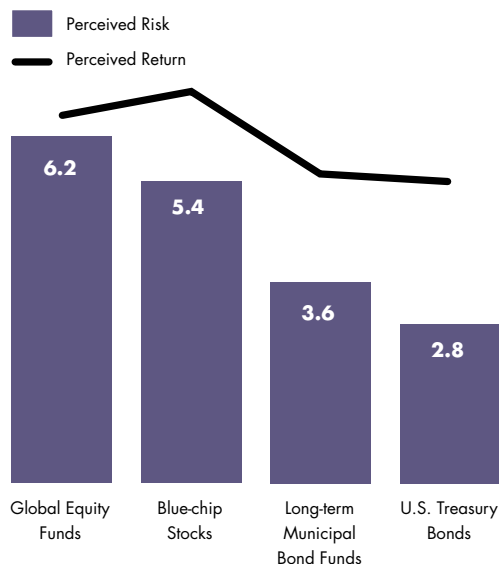
Risk is a key element of investing. To the financial community, risk is a multidimensional concept. Investments can have liquidity, credit, inflation, and prepayment risks, among others. To date, however, little information has been available on how individual investors view investment risk. Recognizing the need to fill this information gap, the Investment Company Institute undertook a survey in the summer of 1992 to learn more about mutual fund shareholders' understanding and perceptions of risk.

The research found that most shareholders tend to perceive risk as the potential to lose principal—a narrow, one-dimensional view. Moreover, shareholders think that they understand the relationship between risk and return but, according to the ICI study, some may not. Figure 1 illustrates that shareholders associate more risk with equity investments than they do with fixed-income investments, but that the level of return the associate with each type of investment is similar.

Figure 1

### Shareholders' Perception of Risk and Return for Four Investment Types\*

(mean score)\*\*



\* As of August, 1992

\*\* Mean score, with ten equaling very risky or very high return and zero equaling not very risky or very low return.

Figure 2

### Shareholders' Perception of Risk for Selected Investment Terms

(mean score)\*

High-yield	7.2
Emerging growth	6.9
Maximum-return	6.7
International	6.6
Variable rate	6.3
Short-term	5.5
Blue-chip	4.9
Managed portfolio	4.5
Balanced	4.3
Long-term	4.2
Tax-free	3.7
Fixed-rate	3.5
Guaranteed investment	3.2

\* Mean score, with ten equaling great deal of risk and zero equaling no risk.

Figure 3

### Shareholders' Key Demographic Characteristics by Risk Category\*

<b>Median age</b>	60	51	42
<b>Median household income</b>	\$51,400	\$61,200	\$66,100
<b>Percent of Respondents</b>			
Male	39%	46%	58%
Married	69	77	85
Widowed	17	8	2
Employed full- or part-time	50	68	80
Retired from lifetime occupation	53	31	15
Four-year college degree or more	39	57	66
Graduate degree	22	24	25

\* Respondents were either the household's primary or cofinancial decisionmaker.

Figure 4

### Shareholders' Risk Tolerance by Year of First Mutual Fund Investment

(percent of respondents)



Figure 6

### Shareholders' Change in Risk Tolerance Since Time of First Investment

(percent of respondents)

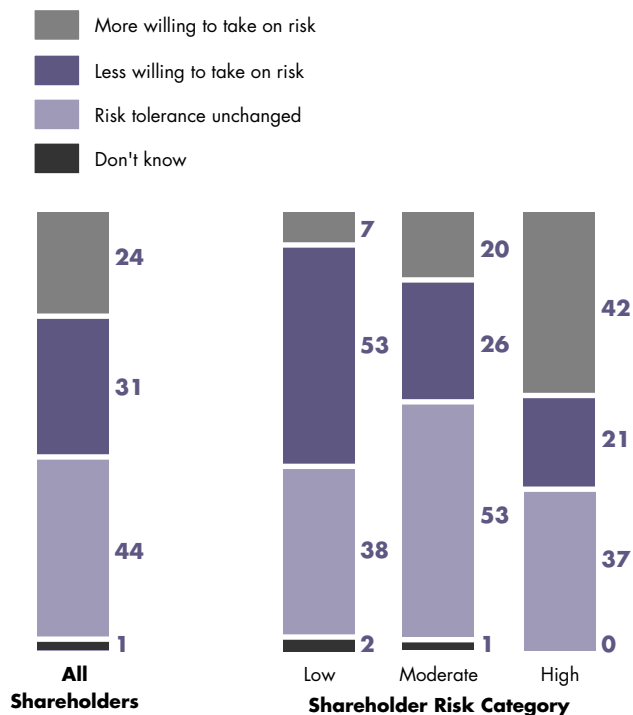


Figure 5

### Shareholders' Use of Selected Sources for Financial Information\*

(percent of respondents)

\*Multiple responses included.

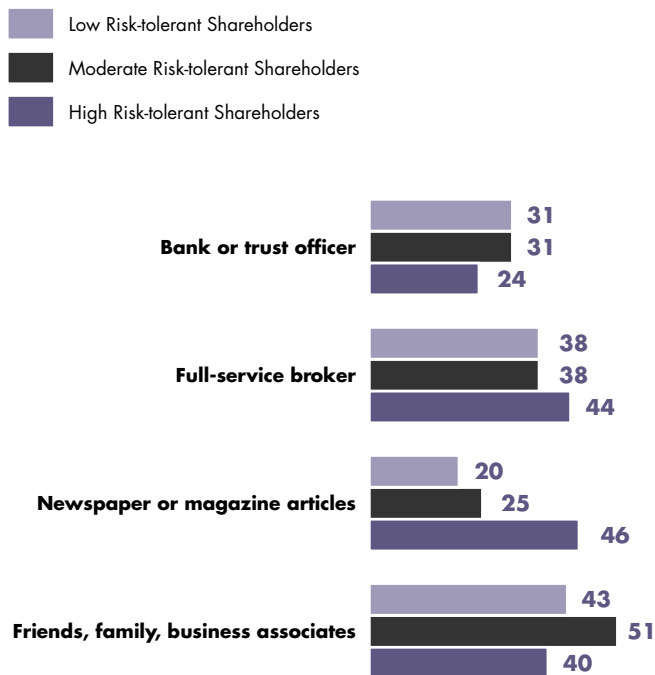


Figure 2 shows that some investment terms suggest more risk to shareholders than other terms. For example, the terms "high-yield" and "emerging growth" connote more risk than do either "fixed-rate" or "guaranteed investment."

Mutual fund shareholders are not homogeneous in their tolerance for investment risk. The research categorized shareholders as either low, moderate, or high risk-tolerant based on their responses to key questions. Altogether, 34 percent of responding shareholders fell into the low risk-tolerant group, 36 percent fell into the moderate risk-tolerant group, and 30 percent fell into the high risk-tolerant group. Figure 3 presents the demographic characteristics of shareholders based on their risk-tolerance category. Figure 4 identifies the risk tolerance of shareholders according to the year in which they purchased their first mutual fund.

When compared with low risk-tolerant shareholders, high risk-tolerant shareholders tend to be confident, self-reliant, and very involved in their personal finances. Illustrating their independent nature, high risk-tolerant shareholders are the group most likely to read a newspaper or magazine article for investment information. (Figure 5)

Risk tolerance can change, which is good news for investor education programs. As depicted in Figure 6, more than half of all shareholders indicate that their tolerance for risk changed from the time of their first investment. This finding reinforces the idea that an investor's position on the risk-reward spectrum is often dynamic.

For more information, see the Institute's 1993 publication, ***Piecing Together Shareholder Perceptions of Investment Risk.***