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# Expensive babysitters or trusted professionals? Financial advice and portfolio rebalancing in retirement savings

Presenter: Thomas Hendry

# ACKNOWLEDGEMENT OF COUNTRY

*Griffith University acknowledges the Traditional Custodians of the land on which we are meeting and pays respect to the Elders, past and present, and extends that respect to all Aboriginal and Torres Strait Islander people.*



Queensland, Australia

# Motivation

The babysitter analogy...

*“...advisors are similar to babysitters: babysitters are matched with well-to-do parents, they perform a service that parents themselves could do better, they charge for it, but observed child achievement is not boosted by babysitters but by positive characteristics of the family.”*

(Hackethal et al., 2012, p. 510)

# Motivation

Which really means...

*“...advised accounts offer on average lower net returns and inferior risk-return tradeoffs (Sharpe ratios). Trading costs contribute to outcomes, as advised accounts feature higher turnover, consistent with commissions being the main source of advisor income.”*

(Hackethal et al., 2012, p. 509)

This study has been cited approx. 600 times and is published in one of the leading finance journals!

# Motivation

The literature on financial advice:

*“...the existing literature on financial advice has raised serious concerns about the willingness of those most in need to obtain and to follow advice, the quality of the advice given and its dependence on incentive schemes, and the potential of market forces to mitigate financial misconduct.”*

(Gomes et al. 2021, p. 981)

We refer to the two underlined problems as the matching problem and the quality problem.

# Theory

- Is there a theory to explain these empirical results?
- Yes...and it is all about conflicts and advice biases!
- Inderst and Ottaviani (2009) show that, in equilibrium, certain conditions affect advice bias:

## Conditions which reduce advice bias:

- fines/potential reputation damage
- transparency
- effective in-house monitoring

## Conditions which increase advice bias:

- sales incentives
- difficulty investigating client/product match



# Contributions

- Prior studies find evidence that the *matching problem* and the *quality problem* can be plausibly explained by conflicts and advice bias theory (Bhattacharya et al., 2012; Chalmers & Reuter, 2020; Hackethal et al., 2012)
- However, samples are collected overseas using older brokerage data and primarily examine returns in normal market conditions (MacDonald et al., 2023)
- We extend the literature by examining:
  - A progressive regulatory environment in 2023 (Australia)
  - Advice related to retirement savings
  - Additional portfolio outcomes (downside risk, diversification)
  - Advice during a crisis period (i.e., the COVID-19 pandemic)



# Research questions

**RQ1:** Which characteristics are associated with seeking financial advice prior to rebalancing? (*the matching problem*)

**RQ2:** Does getting advice prior to rebalancing\* improve retirement portfolio outcomes? (*the quality problem*)

\*Defined in this study as within 90 days



# Data and analysis

## Data:

- Obtained from a large Australian defined contribution pension fund
- Sample period from 2017 to 2023
- Comprises 55,577 retirement portfolio rebalances made by members

# Data and analysis

## Analysis:

- A series of linear probability regressions (as per Hackethal et al., 2012)

### RQ1:

- Outcome: received advice within 90 days of rebalance
- Predictors: gender, age, rebalance size (to proxy wealth)

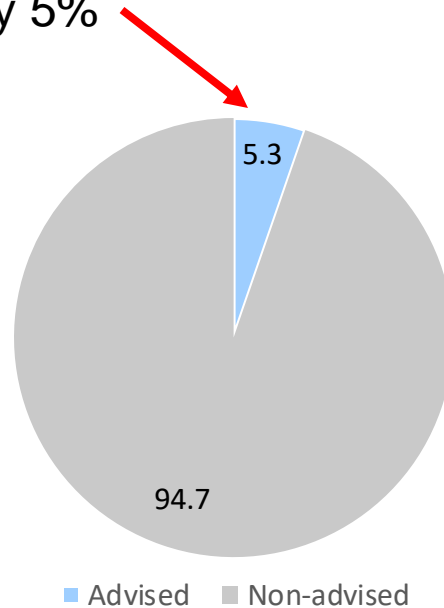
### RQ2:

- Outcomes:
  - Returns (mean over sample period)
  - Alpha (based on CAPM)
  - Sharpe ratio (risk-adjusted returns)
  - Standard deviation of returns
  - Worst month return\*
  - Concentrated rebalance (into 1 single sector fund)\*
- Predictor: received advice within 90 days of rebalance (plus controls)

# Summary statistics

How many people obtain financial advice prior to rebalancing?

- Very few – approximately 5%

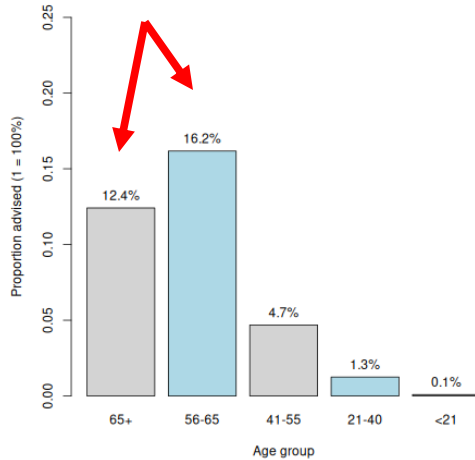


# Results: RQ1

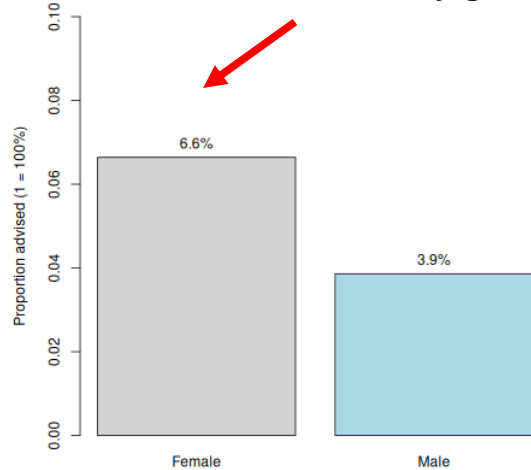
## Is there a matching problem?

- Yes – older, female and (likely) wealthy members are more likely to get advice prior to rebalancing
- Regression coefficients support these results

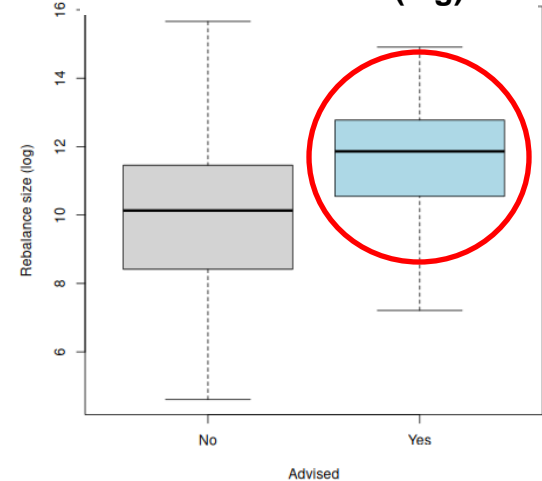
Advised rebalances by age



Advised rebalances by gender



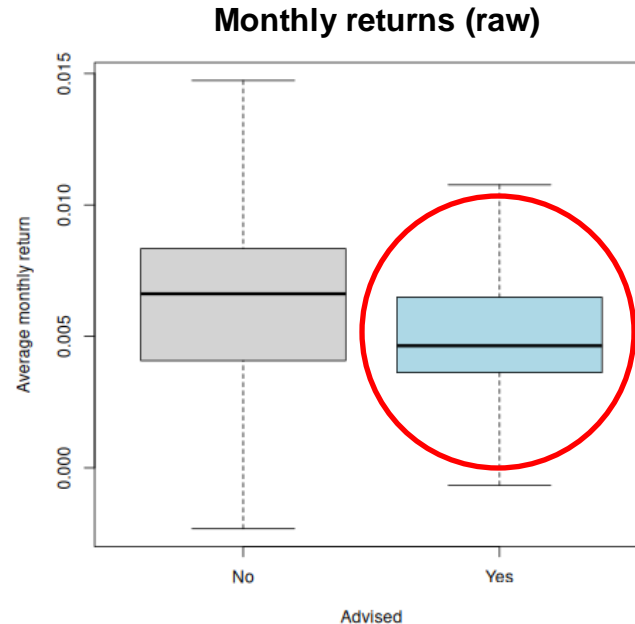
Rebalance size (log)



# Results: RQ2

## Is there a quality problem?

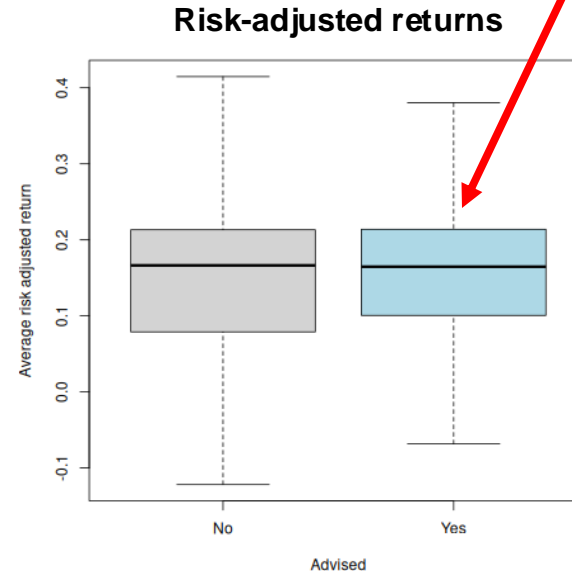
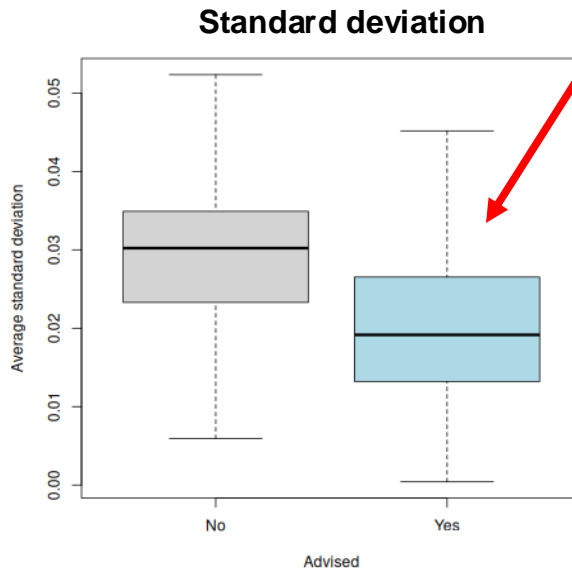
- Perhaps – advised rebalances achieve lower raw monthly returns (mean): 0.63% vs 0.52% (and a much lower alpha)...



# Results: RQ2

## Is there a quality problem?

- ...but advised rebalances are also much less risky and achieve slightly higher risk-adjusted returns



# Results: RQ2

## Is there a quality problem?

- The risk-adjusted returns for advised rebalances is a notable finding
- This result is different to Hackethal et al. (2012):
  - Their study used German brokerage data from 2003 to 2005

	Our study		Hackethal et al. (2012)	
	Advised	Non-advised	Advised	Not advised
Sharpe ratio	0.1582	0.1473	0.1916	0.2229

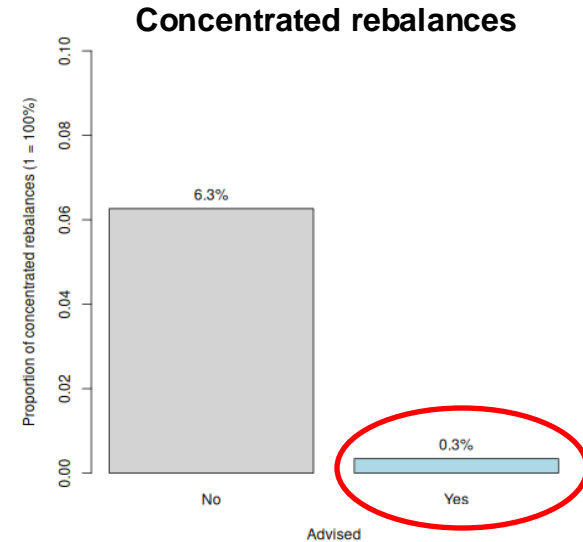
We use the Hackethal et al. (2012) analysis of independent advisors. The difference is even larger for bank advisors.



# Results: RQ2

## Is there a quality problem?

- Advised rebalances have less extreme negative returns and are generally more diversified



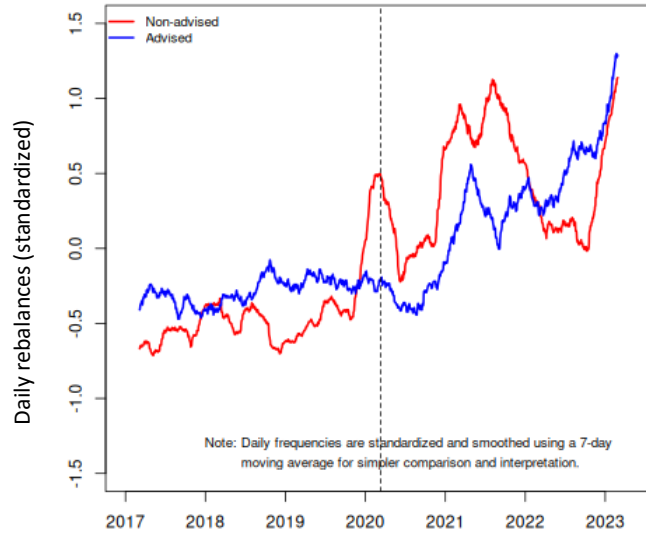
Note: a concentrated rebalance is where 100% is allocated to one *single-sector* fund.

# Results: RQ2

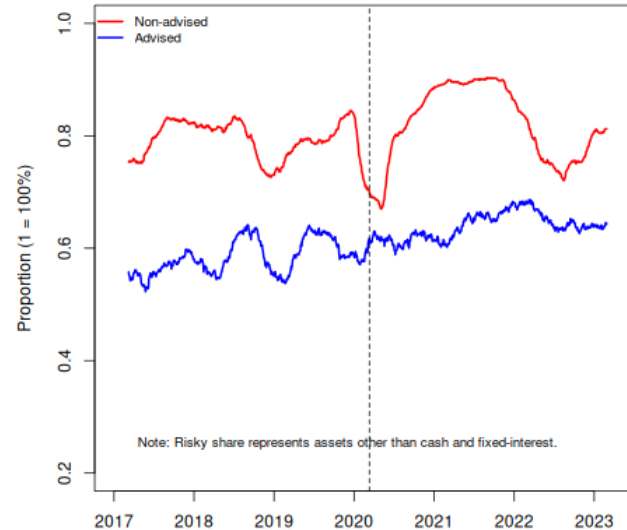
## Is there a quality problem?

- Advised rebalances appear less reactive to volatility during COVID-19 (vertical line)

Daily rebalances over time



Risky share by rebalances over time

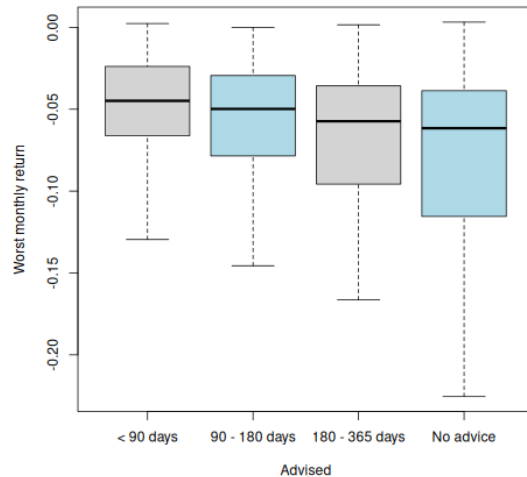


# Results: RQ2

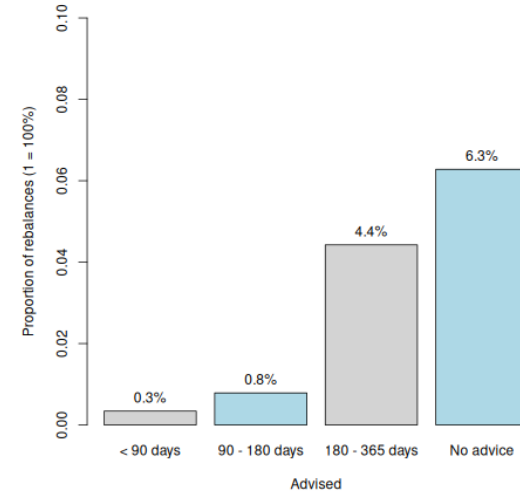
## Is there a quality problem?

- Advice received more than 90 days prior to rebalancing is still related to some outcomes.

Worst monthly return by advice lag



Concentrated rebalance by advice lag



# Results: RQ2

## Is there a quality problem?

- There is no evidence that advisers recommend higher fee funds run by the pension plan provider (also their employer)

Not significant (coefficient also in the “wrong” direction)

	Portfolio fees (log)	
	(1)	(2)
Advised (= 1)		-0.376 (0.514)
Female (= 1)	0.004 (0.004)	0.003 (0.004)
Age 65+ (= 1)	-0.521** (0.018)	-0.566** (0.018)
Age 56-65 (= 1)	-0.298** (0.017)	-0.315** (0.018)
Age 41-55 (= 1)	-0.158** (-0.017)	-0.156** (0.017)
Age 21-40 (= 1)	-0.043** (0.016)	-0.040* (0.016)
Transaction size (log)	1.001** (0.001)	1.000* (0.001)
Month dummies	Yes	Yes
Advice-age interaction	Yes	Yes
R <sup>2</sup>	0.945	0.945
Observations	55,577	55,577

# Results: RQ2

## Robustness checks

- Robustness checks for the model predicting slightly higher risk adjusted returns confirm the main findings

	Baseline (1)	High volatility only (2)	Advice < 365 days (3)	No concentrated (4)	Small only (5)	No default (6)
Advised (= 1)	0.027** (12.160)	0.057** (9.450)	0.027** (12.640)	0.024** (11.390)	0.037** (5.290)	0.033** (13.660)
Month dummies	Yes	Yes	Yes	Yes	Yes	Yes
R <sup>2</sup>	0.308	0.110	0.308	0.322	0.345	0.305
Observations	55,577	11,084	55,577	52,269	13,894	51,443

# Limitations

- Rebalances "from" and "to" observed but not the total portfolio
- Potential confounders (e.g., financial literacy) not controlled
- Sample comprises *active investors* and excludes those who simply did nothing
- Results may not be generalizable outside of retirement funds in Australia
- Advisor fees are not observed

# Conclusion and Implications

- The progressive regulatory environment has not changed who is more likely to receive advice and associated benefits (or otherwise)
  - Older, wealthier, and females ✓
  - Younger and less wealthy individuals ✗
- Value of advice evident in the data
  - Higher raw returns ✗
  - Diversification ✓
  - Lower downside risk ✓
  - Stay the course approach ✓
  - Comparable risk-adjusted returns ✓
  - Higher fee fund recommendations ✗
- Need to continue to test results of prior studies
  - Influential in the literature reinforcing *global* skepticism about financial advice
  - More longitudinal data is needed



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