



Volume 12 Number 1, 2003

The Corporate Market for Personal Financial Planning Services Benefits (pp. 1-18)

Emery A. Trahan, Ph.D., C.P.A., C.F.A., Lawrence J. Gitman, Ph.D., C.F.P., C.C.M

The corporate market provides a tremendous opportunity for the delivery of personal financial planning services, yet little is known about the workings of this market. This study develops insights into the corporate market for personal financial planning services benefits and explores opportunities for future research into this market. The results provide new insights into the nature and scope of the market for personal financial planning benefits at large corporations. However, there is room for much additional research into this market on both theoretical and empirical levels.

Financial Inhibition, Financial Activation, and Saving for Retirement (pp. 19-37)

Kirstan A. Neukam, Douglas A. Hershey

In this paper, we describe the construction and psychometric evaluation of two personality-based measures of financial savings motives, and examine their relationship to individuals' retirement savings practices. The Financial Inhibition Scale (FIS) was designed to assess fear-based motives we believed would hinder the process of saving for retirement. The Financial Activation Scale (FAS) was designed to assess goal-based motives we thought would facilitate savings practices. Findings from two separate empirical studies provide support for both the reliability and validity of these new theoretically based measures of financial savings motivation.

Mapping Mutual Fund Investor Characteristics and Modeling Switching Behavior (pp. 39-59)

Mary Jane Lenard, Syed H. Akhter, Pervaiz Alam

Presented at the 2000 Southeast Regional Meeting of the American Accounting Association

Securing a mutual fund that meets investment goals is an important reason why some investors exclusively stay with a particular mutual fund and others switch funds within their fund family. This paper empirically investigates investor attitudes toward mutual funds. Our model, based on investor responses, develops an investor's "risk profile" variable. Results indicate that regardless of whether the investors invest in nonemployer plans or in both employer

and nonemployer plans, they consider their investment risk, fund performance, investment mix, and the capital base of the fund before switching funds. The model developed in this study can also assist in predicting investors' switching behavior.

Optimal Portfolios for Different Holding Periods and Target Returns (pp.61-71)

Sandip Mukherji, Ph.D., C.F.A.

This paper examines the allocations of U.S. financial assets in optimal portfolios that minimize the proportion of downside risk, measured by deviations from target returns, to mean real terminal value. T-bills dominate the optimal portfolio only for short-term investors with a low target. Intermediate government bonds are the major investment for short-term investors with a medium target and for medium-term investors with low or medium targets. For a high target, stocks are the primary component of the optimal portfolio. For medium and high targets over a long holding period, the optimal portfolio consists solely of small stocks.

Country Risk and International Portfolio Diversification for the Individual Investor (pp. 73-93)

Sarkis Joseph Khoury

The international financial markets have not been sufficiently incorporated in the typical portfolio of an American investor, regardless of whether the portfolio is directly or indirectly managed. This paper provides reasons for looking at the international financial markets as an essential ingredient in developing a portfolio strategy, examines the risk/return profile of international portfolios, offers a model for incorporating country risk in the allocation of individual investment funds across financial markets in the world, and shows a list of options in transforming domestic into international portfolios and for hedging their risk.

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Factors Associated with Success on the CFP® Certification Examination (pp. 95-114)

E. Vance Grange, Vickie L. Hampton, Richard Cutler, Thomas P. Langdon, Michael T. Ryan

We surveyed examinees from three administrations of the CFP® Certification Examination. Factors that are statistically significantly associated with passing the exam include primary business activity; highest degree earned; undergraduate GP A; the CP A, Enrolled Agent, and securities licenses or designations; and being a personal financial planning practitioner. Other studies have identified associations between CP A exam success and both highest degree earned and undergraduate GP A. We are not aware of other studies that have established a

relationship between experience in the field and success on the related professional exam. Interestingly, employer incentives for candidates, including bonuses, raises, and promotions, do not have a significant impact on pass rates. © 2003 Academy of Financial Services. All rights reserved.

A Comparative Analysis of Retirement Portfolio Success Rates: Simulation Versus Overlapping Periods (pp. 115-128)

Philip L. Cooley, Carl M. Hubbard, Daniel T. Walz

One of the risks faced by retirees is the possibility of outliving money saved for the retirement years. Knowing the sustainability of withdrawal rates from a portfolio, or at least the risks associated with them, would greatly help retirees deal with this problem. Two procedures proposed to analyze the problem are Monte Carlo simulation and the overlapping periods methodology. This study compares and contrasts the implications of these two procedures for sustainable withdrawal rates from a retirement portfolio. Under some conditions, the procedures produce similar results, but in others the differences are quite large. © 2003 Academy of Financial Services. All rights reserved.

Special Dividends: What Do They Tell Investors About Future Performance? (pp. 129-141)

Claire E. Crutchley, Carl D. Hudson, Marlin R.H. Jensen

Previous research documents positive short-term stock returns at the announcement of a special dividend and evidence of increased earnings at the time of the dividend. This paper examines the long-run performance of firms paying special dividends to determine whether the stock returns and earnings performance continue to improve over the long run. We find that special dividend announcing firms have unexpectedly high earnings the year of the special dividend announcement; however these unexpected earnings decline significantly in the years following the special dividend. Special dividend paying firms also earn significant positive excess returns the year before the special dividend announcement. On average, investors cannot expect the stock and operating performance that precede a special dividend to continue following the announcement. © 2003 Academy of Financial Services. All rights reserved.

The Impact of Housing Choice on Future Household Wealth (pp. 143-164)

Sean M. Hennessey

Is owning a home the correct housing choice for the average household, and, if so, how do we know? In North America, about two-thirds of households own their homes, and this figure is increasing after a period of decline. This paper provides a financial model that can be used to comprehensively analyze the impact the rent/buy decision has on wealth. The results of two case studies suggest that the financial impact of home ownership may not be as positive as perceived by the average North American household. The model can be easily adapted by users to reflect different assumptions. © 2003 Academy of Financial Services. All rights reserved.

Mutual Fund Attributes and Performance (pp. 165-178)

Yin-Ching Jan, Mao-Wei Hung

This paper investigates the relationship between mutual fund attributes and performance. Funds in the same investment objective category are classified into two portfolios according to mutual fund attributes, including load/no-load, size, turnover, expense, and past performance. The stochastic dominance approach is used to test whether a specific characteristic of mutual funds is efficient relative to its counterpart. We find that the relationship between mutual fund attributes and performance differs among mutual funds with different objectives. © 2003 Academy of Financial Services. All rights reserved.

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Valuing Defined-Benefit Plans (pp. 179-199)

William W. Jennings, William Reichenstein

We examine issues surrounding the valuation of defined-benefit pension plans including benefit formulas, integration with Social Security, postretirement benefit increases, and default risk. We obtain a reasonable valuation with three key estimates—the level of retirement benefits, the growth rate of postretirement benefits, and the discount rate. We consider the PBGC guarantee afforded many DB pensions. Usually, benefits are essentially default-risk-free, and the discount rate can be based on Treasury yields. We also offer methodological advances over current approaches. DB valuation is crucially relevant to asset allocation decisions and has litigation implications. ©2003 Academy of Financial Services. All rights reserved.

The Impact of the Single-Family Home on Portfolio Decisions (pp. 201-217)

Doug Waggle, Don T. Johnson

This study examines the impact of the single-family home on a family's optimal asset allocation decisions. Many researchers have studied individual investor portfolio allocations to stocks and bonds, but there has been little work examining how home ownership should affect those decisions. We believe the family home and any related financing should be considered part of the portfolio. Using a mean-variance utility function, we examine the effects of home ownership on optimal portfolio allocations to stocks and bonds. Failing to include the home and its financing can have a major impact on the optimal asset allocation strategy for a family. ©2003 Academy of Financial Services. All rights reserved.

Household Income, Asset Allocation, and the Retirement Decision (pp. 219-238)

Karen Eilers Lahey, Doseong Kim, Melinda L. Newman

We examine the financial condition of households as they move into retirement and the relative influence of wealth and income on the decision to retire. We find no significant difference between the net worth of retired and nonretired households, suggesting that retirees are no more adequately prepared for retirement than the nonretired subsample. With respect to portfolio allocation, retired households have significantly more financial assets, with a concentration in fixed-income securities, but home equity accounts for nearly half of their net worth. In addition, other household members' employment earnings generate approximately 40% of income for retired households. ©2003 *Academy of Financial Services*. All rights reserved.

A Grading System for Evaluating Internet Life Insurance Needs Calculators (pp. 239-255)

Saul W. Adelman, Mark S. Dorfman, Brenda Wells

Life insurance purchase decision calculators can be found on many Web sites. These Web sites provide various forms of calculators and make calculations based on different theories. They claim to provide an accurate calculation of how much life insurance a person should purchase. This paper focuses on the factors entering into making the computations. It does not comment on the accuracy of the calculations. Eighty-nine Web sites are graded by the count of raw factors. These factors also are weighted by an "expert panel." Results indicate little difference in raw versus expert weightings of the factors. Results stress the need to follow the needs-based approach. We find much of the variation in the quality of Web site advice results from input factors. ©2003 *Academy of Financial Services*. All rights reserved.

The Development of a Risk Assessment Instrument: A Follow-Up Study (pp. 257-274)

John E. Grable, Ruth H. Lytton

The purpose of this paper is to offer empirical evidence regarding the validity of a 13-item financial risk tolerance assessment instrument originally published by Grable and Lytton (1999) in this Journal. Bivariate and multivariate analyses were used to evaluate data from a sample of individuals who reported both having investment assets and making their own investment decisions. The analysis indicated that responses to the 13-item instrument were correlated with portfolio asset ownership as explained by Modern Portfolio Theory. These findings offer support for the concurrent validity (i.e., one form of criterion-related validity) and the construct validity of the assessment instrument. The paper concludes with a recommendation for further study, such as using the instrument in a longitudinal study to ascertain predictive validity. © 2003 *Academy of Financial Services*. All rights reserved.

Search, Adverse Selection, and the Services of Financial Experts

(pp. 275-291)

James A. Ligon

A financial expert holding a particular qualification may make an unobservable investment in the expert's skills. Experts making such an investment can better customize their services to clients' needs, which some clients value. Quality enhancement is more likely the more customers prefer customization, when profit margins for customization are higher, as customer search frequency and the speed of information dissemination increase, and as the expert's discount rate, the cost of the quality enhancement, and the number of experts in the market decrease. The latter result indicates expansion of the number of providers holding a particular qualification is not unambiguously desirable. © 2003 Academy of Financial Services. All rights reserved.

Who Makes the Financial Decisions in the Households of Older Americans?

(pp. 293-308)

Harold W. Elder, Patricia M. Rudolph

Household decision making is at the heart of economic activity; yet very little is known about the actual process. Traditionally, economic modeling of households has treated the decision making process as equivalent to having one person make the decisions. Dissatisfaction with this approach has led to the development of models that imply that the decisions are the product of a bargaining process within the household. We analyze data from the Health and Retirement Survey (HRS) to examine financial decision making within the households of older Americans. Our results are generally consistent with the bargaining model of household behavior. © 2003 Academy of Financial Services. All rights reserved.

Section 529 Plans As Retirement Accounts

(pp. 309-318)

Andy Terry, William C. Goolsby

Section 529 plans were created to provide tax incentives for savings for qualified higher education expenses (QHEE). Earnings in 529 plans are tax-free if withdrawals are made for QHEE, otherwise there is a 10% penalty on the earnings, which are taxed at ordinary rates. Although nonqualified withdrawals are subject to a 10% penalty on the earnings, taxes on the earnings are deferred until withdrawal. This paper examines the use of Section 529 plans as retirement accounts by comparing after-tax and after-penalty future dollars from Section 529 plans with after-tax future dollars from ordinary taxable investments and tax-advantaged annuities. © 2003 Academy of Financial Services. All rights reserved.

The Mortgage Refinance Decision: An Equation-Based Model (pp. 319-337)

Gary L. Hoover

Given recent historically low interest rates, homeowners have been heavily involved in the process of refinancing their home mortgages. This paper examines current refinance analysis methods, and finds most advocate various forms of break-even analysis. In essence, these methods primarily differ with respect the variables considered, complexity of analysis, and solution accuracy. This paper develops an equation-based model that considers the generally relevant variables, while decreasing the complexity of analysis to the solution of an equation. In addition, the model permits an effective comparison of alternative loan terms, determines the expected refinance savings, and solves for the opportunity gain or loss of a refinance deferral. © 2003 Academy of Financial Services. All rights reserved.

Choosing Between Tax-Advantaged Savings Accounts: A Reconciliation of Standardized Pretax and After-Tax Frameworks (pp. 339-357)

Stephen M. Horan

Previous research models the choice between a traditional IRA and Roth IRA by standardizing either the pretax investment or the after-tax investment. This paper synthesizes these two approaches and develops a unified model that accommodates changing tax rates and different types of tax structures during the accumulation phase. Simulations indicate that the investor's withdrawal tax rate is important in making the optimal choice. We also argue that uncertainty about future tax rates increases the value of the traditional IRA, but that in any case investors benefit from having a portfolio of both traditional IRAs and Roth IRAs when withdrawals are made. © 2003 Academy of Financial Services. All rights reserved.