How Families Really Manage Their Wealth

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Walk into any bookstore today and you will notice the business section is chock-full of titles promising the reader a few simple steps that will lead to instant riches or long-term financial security. Live in a high-income neighborhood and your mailbox is filled with solicitations from financial service firms offering free dinners at fancy restaurants, which give them the opportunity to explain in person how well they will manage your money. The bookstore and advertising on many media outlets encourage self-reliance in making financial decisions. The financial services industry encourages using professionals to make financial decisions. How do families really decide? Have these choices changed over time? What are the results of making these choices? Answers to these questions are found in what follows.

These questions are important, first, because of large increases in the typical family's wealth. Since the end of World War II families in the United States have experienced a spectacular increase in their wealth. After adjustment for inflation, the typical household's net worth has doubled since 1946 (Federal Reserve [2005]). Beyond general wealth growth the United States is experiencing a rapid increase in the very rich, with the numbers of millionaires and billionaires soaring. Merrill Lynch estimates there are almost 2.5 million people in the United States who have at least $1 million in financial assets, which is almost a 10% growth over the previous year (Merrill Lynch and Cap Gemini [2005]). As wealth grows, the importance of understanding people's choices in managing that wealth increases.

Matching this steady growth in wealth has been an increasing array of financial choices and products for both borrowing and investing. Choices have increased first because an array of sophisticated financial products have been developed. For example, home buyers 50 years ago had little choice when borrowing money, since almost all mortgages were for 30-year fixed rate terms. Today, not only is there a choice between fixed and variable rates, but there are also hybrid loans that are fixed for a few years and then variable. Choices have also increased because of the growing internationalization of financial markets. Although most stock and bond purchasers in prior generations had limited investment options in countries outside the United States, today investing in foreign companies and foreign markets is no more difficult than investing domestically. This broader set of choices makes financial decisions more complex and time consuming for people trying to minimize their borrowing costs and maximize their investment returns.

Given both rising wealth and increasing financial complexity, to whom do people turn when making choices? Are people increasingly using professionals, such as brokers, lawyers, and financial planners, or are they still using the same methods that served them well in the past? This article shows that not surprisingly people are steadily switching to more professional management. However, a significant number of people, even among the very rich, are still self-reliant. People using professional management make better borrowing decisions.

The data are not as clear on the investment side. It is far from certain that professional management results in a better outcome than using other methods.

REASONS WHY

Where do people get their financial advice? Sources of advice can range from casual conversations with a friend over a few drinks to detailed estate planning strategy sessions attended by a bevy of lawyers, accountants, and money managers. As the introduction pointed out there are really just a few major categories to consider: some people are self-reliant, others rely on professionals, some are eclectic and do both their own research and consult with professionals. The final case, which was unexpected by this author, was a relatively large group of people who do not seek out advice and simply live their financial life on autopilot.

Why do many families use professional help? As financial markets and products get more complex over time the level of sophistication needed to understand and trade in these markets becomes higher. Getting professional advice enables people to focus on their big financial picture without needing to understand the details and mechanics of the actual trades or products. Another reason for using professional advice is that it provides an entrée into products such as hedge funds and private placements that are not open to the general public. A third reason is that professionals are often better at making emotionally difficult decisions, such as being able to sell losing stocks or bonds, a task that many individual investors find difficult. Finally, many people use professional help because they are either not interested in understanding the financial markets or do not want to devote the time needed.

Although there are compelling reasons for having professional management, there are also many reasons why families do it themselves. First, the costs are lower. By doing it themselves, families incur no management or other fees to reduce investment returns or increase borrowing costs. Beyond lower costs, families doing it themselves are ensured that there are no conflicts of interest or perverse incentive effects occurring where a professional is seeking to improve his or her own situation not his or her client's (Damato [2005]) Finally, people who do it themselves often have a better understanding of their own needs, risk tolerance, time horizons, and future plans than a professional trying to optimize for them.

Being self-reliant or relying solely on a professional represent the end points along the financial advice spectrum. Many people use a combination of self-reliant and professional methods in an attempt to blend the best features and avoid the worst of each. Now that the reader has a general idea of the reasons why people use various sources of financial advice, the next section provides an overview of the data source used to determine where people get their financial advice.

DATA SOURCE

The preeminent source of information on the wealth holdings of people in the United States is the Federal Reserve's Survey of Consumer Finances (SCF). The Federal Reserve, which is the U.S. central bank, runs the survey every three years to provide the government with a very detailed view of family's financial situations. The survey asks a very large number of questions about a family's assets, liabilities, income, and other key aspects of its financial situation. Since the 1980s the survey has been done every three years as a series of face-to-face interviews with the financially most knowledgeable adult in the family.

Because wealth in the United States is not evenly distributed but is highly skewed, the survey randomly selects two different groups of families for interviewing. The first group is randomly selected based on where people live. This ensures a cross-section of U.S. society, from richest to poorest, is captured by the survey. The second group is randomly selected from individuals who reported high income to the Internal Revenue Service on their income tax forms. This second set ensures that information from the very richest people in the United States is also collected. When the results from these two groups are combined, an accurate picture of wealth in the United States is captured. Each survey tracks the responses of more than 4,000 families. Since data from the 2004 SCF will not be publicly released until mid-2006, the numbers here are based on the 2001 survey, which is the most recent available.

The reader should take away from this section that the numbers in this article are representative of the entire U.S. population. The article is *not* based on just a carefully selected group of wealthy individuals or customers of one particular financial services company.

TYPE OF ADVICE USED

The SCF contains thousands of pieces of data. The most important to answer our questions ask about financial attitudes and expectations. In the attitude section the interviewer asks how the family makes borrowing and investing decisions by reading two key questions. The question that determines how the family makes investment decisions reads as follows:

> How do you (and your spouse/partner) make decisions about savings and investments? Do you call around; read newspapers, material you get in the mail, use information from television, radio, an online service or advertisements? Do you get advice from a friend, relative, lawyer, accountant, banker, broker, or financial planner? Or do you do something else?

The borrowing decision question is almost identical except that the words "savings and investments" are replaced with the words "credit or borrowing." Respondents are allowed to state up to 15 responses, but the vast majority provide just 1 or 2. The survey provides 25 unique responses by separating out categories such as lawyer from accountant. Analyzing each one of the 25 categories separately, however, loses the big picture. To capture the broad trends each family's responses are condensed into 1 of 4 categories.

If a family's responses indicated only that a professional was used, such as a lawyer, banker, accountant, broker, or financial planner, it was marked as "Professional Only." If the family stated it does not shop around, uses just its past experience, or just uses the same institutions, it was marked as "Unchanging Pattern." If the family stated it called around, read magazines, listened to the radio or watched television, or relied on friends or relatives, it was marked as "Self-Reliant." Finally, if the family fell into multiple categories, for example by both using a professional broker and reading investing magazines, it was considered "Eclectic." Because only half (51.7%) of all families used the same approach for making both investment and borrowing decisions, the exhibits break down the type of advice separately for borrowing and investing.

What type of advice do families use to make borrowing and investing decisions? Exhibit 1 shows that as net worth increases a family shifts toward using just professional help. For making borrowing decisions, the percentage using only professional help rises from 11.3% for those with a net worth under $100,000 to 25.8% for families whose net worth is greater than $10 million. Using a professional to make investing decisions follows the same pattern, peaking with 32.2% of families with net worth over $10 million. Interestingly, across the wealth spectrum not a single category of family uses only professional help as its primary method of making financial decisions.

The rest of the exhibit shows that a small but significant fraction (between 4 and 9%) of people do not periodically reevaluate their borrowing or investing advice but are stuck in an unchanging pattern. The exhibit also shows families with low net worth are much more self-reliant in making financial decisions than wealthier families, with around half (56.3% borrowing and 45.5% investing) of those with a low net worth (<$100,000) making their own decisions compared with around a tenth (13.8% borrowing and 10.5% investing) among those with very high net worth (>$10 million). Last, as net worth increases people increasingly use more varied forms of advice, as seen by the steady rise in the eclectic category.

What are the important ideas to take away from this section? First, the richer the

EXHIBIT 1
Type of Advice Used by U.S. Families in 2001, by Net Worth

	Under $100,000	$100,000 to $500,000	$500,000 to $1 million	$1 million to $5 million	$5 million to $10 million	Over $10 million
Borrowing						
Professional Only	11.3%	14.8%	22.3%	18.2%	25.7%	25.8%
Unchanging Pattern	3.8%	4.3%	3.2%	4.1%	4.2%	6.7%
Self-Reliant	56.3%	39.4%	34.6%	24.9%	17.6%	13.8%
Eclectic	28.6%	41.5%	39.9%	52.9%	52.5%	53.7%
Investing						
Professional Only	17.6%	25.7%	26.5%	28.5%	37.2%	32.2%
Unchanging Pattern	8.3%	7.7%	6.6%	7.9%	9.5%	8.4%
Self-Reliant	45.5%	28.1%	24.8%	15.0%	7.1%	10.5%
Eclectic	28.5%	38.5%	42.0%	48.6%	46.2%	48.9%
% of U.S. Families	53.1%	32.3%	7.7%	5.7%	0.8%	0.4%

family, the more likely it is to use professional help. Nevertheless, even among the very wealthy there is a large fraction who are completely self-reliant when making investment and borrowing decisions. If you work in financial services this means as the United States continues to grow wealthier the potential pool of clients will continue to grow. However, if you are a wealthy individual and still managing your own finances, take heart, there are many others out there like yourself who prefer to do it themselves.

TYPES OF SOURCES

How many different sources do families use for advice and how extensively do they shop around? These questions are answered in Exhibit 2, which shows in its top two lines the number of different methods reported by people to find borrowing and investing information. The top two lines show first that as people's wealth increases they use more methods to find both credit and savings advice. More important, for every wealth category, people report seeking more sources of advice for borrowing decisions than for investing.

It is strange that the typical U.S. family reports using more methods and spending more time shopping for the best deal for borrowing money than for making its investment decisions. The typical family holds far more assets than debts, whether or not homes and mortgages are included. Families who want to maximize their wealth should spend the most time and effort on making investing decisions on the largest component of their financial picture. Given that assets outweigh debts, a purely rational approach means families should spend more time shopping for investment advice than for borrowing advice.

What are the key ideas shown in this section? The typical family spends much more time and effort on borrowing decisions than on making investing decisions. What does this mean? If you or your clients are excessively focused on finding the cheapest loans, to the detriment of finding the highest investment returns, stop and reconsider the priorities. Many families' stated goal is to maximize their wealth. However, their actions suggest they are not focusing on this task.

EXHIBIT 2

Amount of Financial Advice Used by U.S. Families in 2001, by Net Worth

	Under $100,000	$100,000 to $500,000	$500,000 to $1 million	$1 million to $5 million	$5 million to $10 million	Over $10 million
No. of Methods Used for Borrowing (Mean)	2.3	2.5	2.4	3.0	2.8	2.8
No. of Methods Used for Investing (Mean)	1.8	2.1	2.3	2.6	2.5	2.7
Amount of Borrowing Shopping (1 none to 5 large amount)	3.0	3.2	3.3	3.2	3.1	3.3
Amount of Investing Shopping (1 none to 5 large amount)	2.7	3.0	3.3	3.2	3.1	3.5

The bottom two rows show the amount of shopping around done by the family. The survey asks people to rate themselves, with a 1 being almost no shopping, 3 being moderate shopping, and 5 being a great deal of shopping. As wealth increases, families report more shopping for both borrowing and investing advice. Comparing the two lines again shows people reporting either more or at least the same amount of shopping for credit as for savings.

OVER TIME

Have U.S. families changed the type of investment and borrowing advice they have used over time? The SCF has put the two questions that track the sources of advice into three different surveys. Instead of breaking the types of advice down by net worth categories, Exhibit 3 uses data from the 1995, 1998, and 2001 surveys to show the trends over time for the average U.S. family.

The exhibit shows families over time have been increasingly moving toward professional only services, with a rough doubling of the percentage since 1995. This finding makes sense given the increasing complexity of financial choices available to families. Since 1995 the eclectic category has also been growing, with the percentage rising from the high teens/low twenties to the mid-thirties.

EXHIBIT 3

Changes over Time in Type of Advice Used by U.S. Families

	Borrowing				*Investing*		
	1995	*1998*	*2001*		*1995*	*1998*	*2001*
Professional Only	6.5%	12.0%	13.9%		13.9%	22.2%	22.1%
Unchanging Pattern	5.9%	3.6%	3.9%		12.4%	8.5%	8.0%
Self-Reliant	70.8%	45.3%	46.9%		53.4%	34.4%	35.4%
Eclectic	16.8%	39.2%	35.3%		20.3%	34.9%	34.6%

EXHIBIT 4
Effectiveness of Various Advice Methods for Borrowing in 2005

	Overall	Professional Only	Unchanging Pattern	Self-Reliant	Eclectic
Loan Rate (Mean)	9.5%	8.8%	10.1%	9.9%	9.0%
Loan Rate (Median)	8.0%	8.0%	8.9%	8.3%	8.0%
Total Loan Amount (Mean)	$81,061	$83,632	$64,769	$64,818	$106,303
Total Loan Amount (Median)	$40,800	$36,000	$23,400	$35,450	$59,400
Amount of Borrowing Shopping	3.1	2.7	2.4	3.2	3.6

Although using professional advice and being eclectic have grown, families since 1995 have become less likely to be self-reliant. Almost 71% of all families stated they were self-reliant in making borrowing decisions in 1995; by 2001 only 47% were completely self-reliant. The same sharp drop is seen on the right-hand side of the exhibit, which looks at investing. In 1995 over 53% stated they were self-reliant; by 2001 just 35% were self-reliant. Finally, the number of people stuck in unchanging patterns has also fallen over time, but the drop has not been as dramatic as seen in the self-reliant category.

What does this section show? Over time fewer families are purely self-reliant for making financial decisions. Over time more families are either using just professional advice or taking a more eclectic approach. The constantly increasing complexity of financial choices should only increase this trend in the future. Nevertheless, do-it-yourself finances are headed not for extinction but for a time when a more select group manages their finances this way.

MOST EFFECTIVE METHODS FOR BORROWING

The exhibits provide interesting numbers on how people obtain advice. Does it really matter how the advice is obtained? Does one type of advice result in lower borrowing rates or higher investment returns? This and the next section show that the type of advice does matter.

First, which advice method produces the best deal on loans? The SCF asks respondents about many different debt categories such as home mortgages, credit card debt, student loans, and car loans. Overall, the survey has space for respondents to report up to 30 different loans. For each loan identified, the respondent is asked a great many details about the loan such as the original loan amount, the amount currently outstanding, the current interest rate, and where the respondent is in the payment process. Using this information a weighted cost of funds was computed for each family that had any loans outstanding by multiplying the current interest rate on each loan by the share each loan represented of the family's total debt.

The top two rows of Exhibit 4 show that the typical family that had taken out a loan was paying around 9% (9.5% mean and 8.0% median). The next two rows down show the typical family owes less than $100,000, with a mean amount owed of $81,061 and a median of $40,800. Finally, the last row uses the same 1-5 scale discussed in Exhibit 2. It shows that the average family rates itself as a 3.1 (3 is a moderate shopper).

Breaking the families with loans into the four types of advice categories not surprisingly shows that people who report unchanging patterns of credit advice both pay the highest interest rates and do the least shopping. Individuals who are self-reliant pay the second highest set of interest rates (9.9% mean and 8.3% median). Comparing the other columns shows that people who are eclectic pay slightly higher rates than those who use professional help only, but those who are eclectic report much more time shopping for the best terms than those who use professional help.

In brief, this section shows that when people are borrowing money, those who rely on just professional advice end up with both the lowest interest rate and the least time expended. Individuals who are eclectic advice seekers pay only slightly higher rates than those relying on professional help but spend much more time shopping than any other group. Hence, this exhibit suggests families relying on professional advice are optimizing both their finances and their time.

MOST EFFECTIVE METHODS FOR INVESTING

Which advice method produces the best returns for investing? The SCF provides two different methods of determining which method of investing yields superior returns. First, the survey asks all respondents who own stock how much their portfolios have gained or lost in

EXHIBIT 5
Effectiveness of Various Advice Methods for Investing

	Overall	Professional Only	Unchanging Pattern	Self-Reliant	Eclectic
Stock Change (Mean)	36.1%	30.1%	31.1%	29.5%	40.1%
Stock Change (Median)	3.0%	0.8%	2.0%	3.1%	2.0%
Stocks Portfolio Size (Mean)	$192,078	$225,991	$335,236	$94,027	$169,693
Stocks Portfolio Size (Median)	$20,000	$30,000	$15,000	$12,000	$17,000
Amount Investing Shopping	2.9	2.8	2.6	3.1	3.2
Unusual High Invest. Income	18.7%	23.6%	19.7%	8.8%	20.7%
Unusual Low Invest. Income	6.9%	7.0%	12.8%	5.4%	4.7%
Ratio	2.7	3.4	15	1.6	4.4

value since the stocks were obtained. To prevent a few outliers from skewing the results, any respondent who stated his or her portfolio grew by more than 1,000% was given a value of 1,000%. Looking at the top two rows of Exhibit 5 shows that the mean change is around 30% for the professional, those stuck in the same unchanging patterns, and those who are self-reliant. Only individuals who used eclectic investment advice recorded higher (40%) investment gains. The median line, which also tracks the average but does not give any weight to extreme outliers, shows individuals who use professional investment advice had the smallest gains (0.8%) while the self-reliant had the largest.

The middle section of the exhibit shows the size of the stock portfolios and reveals that while the self-reliant had some of the best percentage returns, this was achieved using the smallest portfolios. In addition, those people who are self-reliant or eclectic investors spend more time shopping for investment advice than those who use professional advice. As with the data for borrowing, individuals who report they have unchanging investment patterns spend the least amount of time shopping for investment advice.

Unfortunately, the question about the family's stock market returns is not perfect for a number of reasons. First, it does not cover all financial investments, such as bonds and mutual funds. Ignoring these other financial choices ignores a significant portion of many portfolios. Second, the question asks about financial performance since all stocks were obtained, not over a specific time period, such as the past year. This indefinite time period makes it difficult to interpret the number for individuals who switch investing strategies while holding a portfolio of stocks or who hold their stocks for differing lengths of time.

Because of these problems, the bottom part of Exhibit 5 uses another set of SCF questions that ask whether the family's income was normal or unusually high or low in the past year. If the family's income was unusual it was asked the reasons why. Among all families that reported unusually high income, 18.7% stated their income was unusually high because of capital gains, sales of assets, or higher returns on investments. Scanning across the row breaks people down by how they received investment advice and shows that families who stated they had unusually high income because of investments were much more likely to use only professional advice (23.6%) and least likely to be self-reliant (8.8%).

The next row, labeled "Unusual low investment income," tracks families who stated their income was unusually low because they either had a capital loss or low returns on their investments. In this case people who were stuck in an unchanging pattern were most likely (12.8%) to report low income because of investments, followed by those who used only professional advice. The bottom row takes the ratio of the two unusual income lines and offers a simple method of translating the exhibit's lower section. For example, the overall column contains a 2.7. This means that the typical family is 2.7 times more likely to report having unusually high income because of good investment returns than bad. Ranking the four investing strategies based on the bottom line shows that eclectic investors had the best chance for unusually high income, followed by those who only take professional advice. The least likely are those who are self-reliant and those who follow the same unchanging investment pattern.

This section shows that for investing money the SCF data do not provide a clear picture of which method of investment advice provides the best results. The data provide some quantitative support for each method to claim it is the best.

ANOTHER LOOK

One problem with this analysis is that it shows only the relationship between different advice methods and particular outcomes; it does not take into account other important factors. For example, the type of investment

EXHIBIT 6

Impact of Using a Different Advice Method Compared with Being Self-Reliant

	Outcome Variables		
	Loan Rate	Portfolio Change	Income Change
Professional Only	–0.50%***	–13.5%**	$20,772***
Unchanging Pattern	0.10%	–11.3%	–$2,410
Eclectic	–0.37%***	–1.6%	–$4,236

Notes: *** statistically significant at 1% or better level; ** Significant at 5% or better level.

advice chosen is influenced by the family's age. Older families are more likely found in the professional only or unchanging pattern groups, whereas younger families are much more likely found classified as self-reliant. Another example is that individuals taking out jumbo mortgages often pay higher interest rates, so borrowing costs are partially a function of loan size.

A simple method of handling this problem is to run regression analysis. Regression analysis is a mathematical process that determines the impact of various key ideas (called explanatory variables) on a particular result (called the outcome variable) taking into account a variety of background effects. Three different series of regressions were run to investigate the impact of choosing different types of borrowing and investment advice. The three outcome variables were the average loan rate, which tracks the weighted cost of funds; the respondent's perception of how much his or her stock portfolio grew or shrank in percentage terms; and how much his or her income changed from normal in absolute dollars because of investment gains or losses.

Background variables used to take into account the other important factors are the age of the head of the family, whether the head is self-employed, whether the head is currently married, whether the family owns its home, the family's income over the past year, and its net worth.

Exhibit 6 shows just the key regression results and eliminates all the results for the background variables to keep the exhibit easy to read. In addition, to make the comparison simpler, all calculations are done in comparison with being self-reliant. What does the exhibit show for borrowing? Compared with being self-reliant, families that used just professional advice paid an average of half a percentage point less on their loans, those that used the same unchanging methods paid a tenth of percentage point more, and those who were eclectic paid one-third of a percentage point less.

Given that interest rates are constantly changing, the key point is not the absolute numbers in the column but the ranking. Even after taking a large number of other factors into consideration, people who relied on professional help for borrowing advice had the lowest cost of funds, people who used eclectic sources had the second lowest, the self-reliant came in third, and those who used the same unchanging methods paid the most.

The next two columns look at portfolio and income change and show that even after taking into account a variety of background factors the picture is still not clear-cut. Using only professional advice resulted in the worst ranking in the stock portfolio change column but the best ranking in the income change.

In simple language the portfolio change column means that when people are asked how much their stock grew, those who used only professional advice believed their portfolio's value had done very poorly compared with all other methods. The regression results show that individuals who are self-reliant believe their portfolios have grown the most, followed closely by those who adopt an eclectic strategy. In a distant third place are those who use the same unchanging investment advice, followed by those who use professionals only.

The income change column asks people whether their income was high or low compared with normal and why. Among people who listed capital gains, capital losses, or other investment reasons, those who used only professional advice reaped over $20,000 extra income in a year compared with those who were self-reliant. Again, the specific values are not as important as the rankings, which in this column are professional first, self-reliant second, unchanging third, and eclectic fourth.

This section's key piece of information is that even when more sophisticated statistical techniques are used, the same results are seen. Relying on just professional advice results in both the lowest interest rate and the least time expended when borrowing money. Regression results, however, show that no advice method is a clear-cut winner for getting the best investment results.

CONCLUSION

The reader making it this far has encountered a large number of facts and figures. What are the three most important ideas to take away? First, richer families are more likely to use professional help than poorer families, and over time more families are moving toward professional assistance. However, these points should not hide the key idea that from the richest families to the poorest, many in the United States still make financial decisions without depending on professional advisors.

The second key idea is that people's financial efforts are backward from what should be expected from wealth maximizers. Families reported spending much more time and effort on borrowing than on investing decisions. Given that the vast majority of families' assets greatly outweigh debts, the priority should be on finding the best investments, not the cheapest loans.

The third and final idea is that the different methods of advice impact financial performance. Financial solicitations and investment offers bombard typical families constantly from their televisions, radios, telephones, mailboxes, and computers. Where should families get borrowing and investment advice? Should they use professional advice, do it themselves, be eclectic, or just stick to whatever sources they have been using? The data in the SCF are clear along one dimension. When seeking a loan families should use professional advice. Since the SCF data are not clear on the investment side, families should carefully consider the trade-offs discussed in the "Reasons Why" section before making their investment choices.

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