# Support
# For The Need For Investor Education

Many investors have a weak grasp on reality when it comes to financial matters and are ill prepared to understand the changes that will sweep across the financial landscape due to financial and regulatory changes.  The value added by a financial advisor will come under greater scrutiny than ever before.  A good financial adviser should be able to prevent an investor from making bad choices.  If they cannot, of are uninformed themselves, we don't want them as advisors.

That is an important point, considering that investor education "will never be adequate" to ensure that investors make the right investment decisions on their own,  a spokesperson from investment firm Eaton Vance said.

Evidence of that can be found in a survey of 1,000 investors published in 2005. According to the survey, 84% of investors were optimistic that they would live comfortably in retirement.   But Strategic Insight Mutual Fund Research and Consulting, LLC in New York, said many of those investors will be disappointed, given that studies have shown that investors aren't saving nearly enough to retire comfortably.  It is a serious disconnect that investor education could solve

As changes are made to Social Security, taxes are hiked and the baby boomer generation ages the perception problem could be helped by education.

## Investor Education

Many investors aren't prepared to understand the implications of such changes to their financial health, said an associate professor of finance at the Haas School of Business at the University of California, Berkeley.  Investors must be better educated about the importance of diversification, taxes and mutual fund fees, he said.  What he didn't say was that they first need to understand the basics of investing, like what is a stock, what is a bond and how do the markets move.

For example, respondents to the survey understood little about tax-managed investing. Less than one-third were aware of investments specifically designed to maximize after-tax returns, such as municipal bonds according to the survey.

Taxes are sure to increase, said a senior fellow in the economic- studies program at The Brookings Institution there.  The reason is that you can't pay for a growing budget deficit, Social Security, Medicare and Medicaid without a tax increase, said a former vice chairwoman of the Federal Reserve Board.  It doesn't matter what the newly elected politicians rhetoric says now.  Taxes have to go up, and they will make it happen (although they'll blame the other party, whatever that is).  Ernst & Young agrees.  "Given the demographic shift that is occurring in the country, something has to be done" he said.  “In 2025, the demographic changes will be so great that the entire country will look like Florida.”

If that prediction is accurate, it may not be a good thing for investors, since many aren't informed enough to make good decisions.

The average investor lives somewhere between “ignorance is bliss” and “knowledge is power” and is unsure of just how far they want to go in either direction.  What's more, there's a serious debate in the financial services business about whether an investor should be tilted toward those extremes, or should settle comfortably in the middle.

For proof, consider two recent and very different studies of investors, one concerning knowledge and its ability to provide and create control, and the other about surrendering control, presumably due to a lack of knowledge.  When compared, the two studies make for an intriguing landscape, giving investors food for thought about just what position they want to assume on the financial horizon.

- AARP Financial's “MoneySmarts” survey determined that investors are lost in financial jargon.  More than 40% of the 1,200-plus people surveyed said that information from financial services providers is “not so (helpful) or not at all helpful.”

    - In addition, more than half of the respondents said they do not read financial literature because “it's too hard to understand.”  Almost four out of five respondents said they have an easier time understanding prescription drug inserts or car insurance policies than mutual fund prospectuses.

    - Perhaps most importantly, the survey showed that more than half of the public (52%) confessed to making an investment mistake because they were confused or didn't understand an investment.  The most common mistakes cited were failure to invest or waiting too long to invest.

## Much to Learn

The second study by Bill Sharpe’s Financial Engines looked at the percentage of people whose employers enrolled them in a managed account program, and found that an average of 60% stay with the program.

That's a bit disappointing.  In 2006, the Pension Protection Act was supposed to revolutionize retirement savings and ease the nation's savings shortfall.  Among its more publicized provisions, the Pension Protection Act encouraged employers to automatically enroll workers in a 401(k) plan and to provide default choices, as well as management assistance.

The Financial Engines study showed that when plan sponsors put existing retirement-plan participants into a managed account program -- one where they get some measure of guidance and asset-allocation help -- a big chunk of those folks back out.  Why?

That was not what Congress or most observers expected.  Admittedly, enrollment stays higher for people who are starting a new job and who wind up being automatically put into the plan; industry research shows that closer to four out of five employees stay the course and do not opt out of the retirement-savings plan.  Without automatic enrollment, a retirement plan that can convince roughly half of the employees to participate can brag about a high success rate.

Jeff Maggioncalda, Financial Engines' chief executive officer, said that he believes many of the people who opt out of the managed-account program are deciding to follow their own plan, which is not necessarily a bad thing provided they are educated, informed, indeed saving and headed in the right direction.  But, if investors are bamboozled by the financial jargon, there's a real question of whether what they don't know will come back to haunt them.

“Automatic enrollment is supposed to help people, by letting them focus on what they know,” Maggioncalda said.  “They still have to worry about the big decisions -- how much to save, when to retire, how much risk they can tolerate -- but they let someone else worry about the investments.”

## Two Schools

This is where the schools of thought start to diverge.  On the surface, everyone agrees that financial education is a big deal.  Regulators extracted millions of dollars from mutual fund firms that got caught up in rapid-trading scandals in 2004, and earmarked the funds for investor education (though it's hard to see any real success from those efforts).  Mutual fund firms are busy working on a Securities and Exchange Commission initiative to develop a summary prospectus that helps investors get through the clutter.

But since the AARP study compared understanding investments to understanding an auto mechanic, consider how this situation can play out with an investor feeling more comfortable by knowing just a bit less.

Your car is one of your biggest expenditures, one that -- like your financial nest egg -- you want to make last, in good condition, for as long as possible.  While you can do your own repairs and know what's necessary to keep the car in good working order, most people don't change their own oil, and are better off focusing on keeping the car serviced properly than wondering about the nuts and bolts under the hood themselves.

Consumers can't afford to be ignorant about how a car works lest they wind up overpaying for repairs or simply running the vehicle into the ground by never getting it serviced.  Yet they also don't need to be a trained auto mechanic.

Likewise for investors, who must know the big things -- such as whether they are saving enough, how well they can sleep at night when their assets are exposed to risk, and their time horizon -- but who could leave the finer points of asset allocation to a hired hand.

Yes, investors would be better off if they understood jargon, but we need to help them to take the time to get up the learning curve.  Perhaps the most important thing to know is what they don't know.

“People don't need to know every little thing, but they do need to understand what they are doing,” said a chief investment officer for AARP Financial.  “The problem is that they get put off by the things they don't know, or don't think they know.”

In short, you don't need to be capable of managing a mutual fund in order to invest in one; don't be ignorant, but don't feel like you need an advanced degree in order to make successful choices.  “You don't want to be taken advantage of or have a problem because of what you don't know,” said Maggioncalda, “but there are resources out there, ways for people to put together portfolios where they are focused on finding the right professionals or getting the right guidance, and giving the program enough to work with so that they can reach their goal.”

Money Culture is being developed to **BE** that “primary” resource.