The Wealthier, The Quicker to Sell in a Downturn?

By Kerry Pechter *Thu, May 12, 2016*

In a new research paper, a group of Big Ten economists and an IRS analyst say that wealthy people and older people are the most likely to sell in scary market downdrafts.

Part of the debate over the Department of Labor's fiduciary rule and the related debate over "robo" financial advice has focused on investor behavior during periods of extreme market volatility—like the ones we all endured back in 2008-2009.

Critics of the fiduciary rule argued that it would eliminate commission-based advisors. And skeptics of digital advice predicted that, if it replaced advisors and brokers, middle-class investors wouldn't have any options (other than, say, to a Vanguard or Fidelity phone rep) when the VIX spiked and they needed someone to talk them out of dumping equities.

These arguments puzzled me, because I thought that ordinary savers—retirement plan participants, for instance—were more inclined to inertia than panic during market upheaval. It was all the more puzzling because I also assumed that rich people—the upper 5%—are too smart to sell in a panic. On the contrary: I assumed they were scooping up bargains (as did the Sage of Omaha back in 1975).

But if both those assumptions were true, then who is responsible for the panicky selling? In a new research paper, entitled "Who Sold During the Crash of 2008-2009? Evidence from Tax Return Data on Daily Sales of Stock" (NBER W22209), a group of Big Ten economists and an IRS analyst say that *wealthy people* and older people are the most likely to sell in scary market downdrafts.

Older people, I can understand. Wealthy people? That's somewhat surprising. It contradicts the conventional wisdom that they have financial advisors who can pull them away from the TV and Internet and calm them down.

The jittery 'one percent'

But no. "We find that, starting in September 2008, the share of sales volume attributed to the top 0.1% of income recipients rises sharply until the beginning of 2009. More generally, we find that high-income taxpayers have a greater propensity to sell during periods of market tumult," the six authors of the study wrote. Four were economics professors at the University of Michigan, one was an Ohio State University economist, and the sixth works for the Internal Revenue Service.

“Sales volume rises much more strongly with lagged VIX changes for the top 95-99, 99-99.9, and 99.9-100 income percentiles than for other income groups over the period 2008 to 2009,” they continued. The same was true for people over age 60. “In multi-dimensional analysis, both high income and age over 60 are associated with a strongly positive sales volume-VIX relationship, as are income and receipt of Social Security income.”

High-net-worth and older investors were more likely to sell equity mutual funds than individual stocks. They weren’t more likely to sell financial stocks than other stocks, but they were *less* likely to sell consumer-durable stocks than stocks in other sectors. While high wealth levels tend to overlap with higher ages, the researchers saw separate effects for age and income.

“Younger high-income investors were also selling much more than younger, lower-income investors,” co-author Daniel Reck of the University of Michigan told RIJ in an email. “Basically, we see strong relationship between age and crisis sales at all income levels, and also a strong relationship between income and crisis sales at all age levels. So we conclude that the income relationship isn’t driven purely by the fact that high-income investors are older.”

“Other aspects of investors—gender, marital status, region and state of residence, presence and amount of a mortgage interest deduction, and 2007 zip-code-level house price growth—are not related to the volatility sensitivity of stock sales,” the paper said.

The study was based on data from federal tax returns with the names removed. The economists matched asset sales reported for capital gains taxation purposes with some demographic information on each taxpayer. Asset purchases were identified indirectly, from dividend receipts and a supplementary brokerage account data set “suggesting that individuals with high levels of gross sales are also, to a substantial extent, net sellers of stocks,” the authors wrote.

The study didn’t cover trading in tax-deferred accounts, such as IRAs and employer-sponsored retirement plans, because it was based on IRS data and trades in tax-deferred accounts don’t leave a tax trail.

Reasons for selling

The tendency of high-income investors to sell in high-volatility episodes, the authors wrote, could exist because:

- They tend to pay greater attention to their portfolios.
- They perceive themselves better able to time the market.
- They are more likely to own stocks on margin, which potentially multiplies their losses.
- They blame their money managers for stock market losses and withdraw their funds in response.
- They lose trust in financial intermediaries in response to market turmoil.

"Some investors may be forced to sell due to constraints on their risk-bearing capacity (e.g., leverage constraints, liquidity shocks), some may be less tolerant of short-run risk than the average investor (e.g., close to retirement), some may perceive themselves to be better informed than others and anticipate a further price decline, and some investors may lose trust in the stock market altogether and perceive it as a rigged game," the paper said.

"Individuals trading in mutual funds as opposed to individual stocks are likely more risk-averse and thus more prone to reduce the risk in their portfolios during the crisis by moving their wealth from mutual funds to something safer. Mutual fund investors could also be less confident in their own ability to pick winning stocks, which could make them more likely to sell off in tumultuous times than investors who are confident enough to pick individual stocks."

The researchers added, "The greater sensitivity of older investors is consistent with the idea that investors close to retirement (with less opportunity to make up losses through future labor income) should be particularly sensitive to a perceived rise in risk."

The researchers couldn't rule out the possibility that plan participants and IRA owners were trading just as frequently as the top 5% during volatile markets. They noted that high-income and older people hold a higher share of their wealth in taxable accounts "perhaps due to the limits on contributions to tax-deferred retirement accounts. The same is true of older individuals." Overall, the researchers found it easier to understand why older people sell in choppy markets than to understand why the wealthiest do.

The authors of the paper included Jeffrey Hoopes of Ohio State University, Stefan Nagel, Daniel Reck, Joel Slemrod and Bryan Stuart of the University of Michigan, and Patrick Langetieg of the IRS.