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Reporting to Portfolio Managers and Financial Advisors

Topic: There is a gap in investment products that effectively meet the preferences and risk tolerance of different client segments, particularly in identifying and addressing the needs of underserved high-risk tolerant investors. What combinations of assets should be included in a financial portfolio to better serve them?

Executive Summary

This study examines how risk tolerance affects investment preferences and whether high-risk investors are underserved by financial products. We use data from the 2022 Survey of Consumer Finances (SCF) and previous research by Grable & Lytton (1998) to analyze these patterns. The study is divided into three key parts:

1. Key characteristics of high-risk investors: identifying which demographics are more risk-tolerant.
2. Investment preferences by risk tolerance: analyzing how different risk groups allocate their portfolios.
3. Underserved high-risk investors: exploring which investors struggle to access the high-risk products they seek.

Key Findings

- Men and higher-educated individuals tend to be more risk-tolerant than women and those with less education.
- Married individuals are generally less risk-tolerant compared to never-married individuals, who invest more in stocks.
- Higher-income investors allocate more to stocks and mutual funds, while lower-income investors rely more on real estate.
- Self-employed individuals and entrepreneurs are more comfortable with risk than salaried employees.
- Age is NOT a strong predictor of risk tolerance, challenging traditional financial planning models.
- High-risk investors, especially in emerging markets and self-directed investors, lack structured financial products tailored to their needs.

Implications

Financial firms should offer more tailored high-risk investment products, such as leveraged portfolios, thematic ETFs, and structured derivatives, to better serve self-directed investors, entrepreneurs, and

emerging market participants. Expanding these options will help bridge the gap between investor demand and available financial products.

Context

High-risk tolerant investors often seek speculative, high-return opportunities, yet traditional financial products are typically designed for low-volatility, long-term growth, leaving many of these investors underserved. As seen in our analysis of the 2022 Survey of Consumer Finances (SCF), investment preferences vary based on education, income, and employment status, meaning a one-size-fits-all approach fails to meet diverse risk appetites. Addressing this gap is essential for wealth management firms, financial advisors, and policymakers looking to enhance portfolio customization for high-risk investors. By identifying optimal asset combinations that align with their risk profiles, financial institutions can offer better diversification, improved access to high-growth investments, and tailored financial strategies that meet the evolving needs of self-directed investors, entrepreneurs, and emerging market participants.

Part 1: The key characteristics of high-risk tolerant investors across different demographics?

Multiple research have found socio-demographic factors influencing risk appetite. The 1992 survey of Consumer Finances SCF, conducted by the Federal Reserve Board and the University of Chicago provides a comprehensive overview of US families' finance and demographic characteristics. From this survey containing 2,626 respondents, John E Grable and Ruth H Lytton, conducted a discriminant analysis to investigate which demographic characteristics are the most important in differentiating risk tolerance.

Based on their study the best way to classify an investor's risk tolerance is through education level and gender. Although there has been conflicting opinions on whether gender is a reliable tool to differentiate risk tolerance amongst individuals, there is a persistent belief that men exhibit more risk-taking investment behaviors. One possible explanation is that men have different investment behaviors due to socialization and women generally have lower lifetime earnings. The study also showed that individuals who had higher levels of education are more likely to display risk-loving tendencies. The rationale behind it is that higher education is often associated with better financial literacy, which could lead to greater willingness to take well-informed risks.

Other relevant factors mentioned are as follows: marital status, employment, level of income, and race. The study noted that married individuals might show a lower risk tolerance due to the financial responsibilities with supporting a family, leading to more conservative strategies. When it comes to employment status, self-employed people are more likely to take on risks compared to those who are employed by others. The authors tentatively argued that entrepreneurs are accustomed to working in an environment of uncertainty, leading to a higher comfort level with financial risk-taking. Regarding income levels, individuals with high income tend to have more disposable resources so they are empowered to take on riskier investment decisions. Plus, richer people are more likely to recover from a large loss compared to less wealthier individuals. Note that individuals making more than $1 Million per year were excluded from this study in order to not skew the results. Moving on to race, White people have a higher risk appetite. This is due to historical socioeconomic disparities that prevail.

Finally, it's important to point out that the study showed that age was not a significant factor in differentiating levels of risk tolerance. This challenges common assumptions in financial planning that younger investors are more risk tolerant while older investors tend to be more conservative.

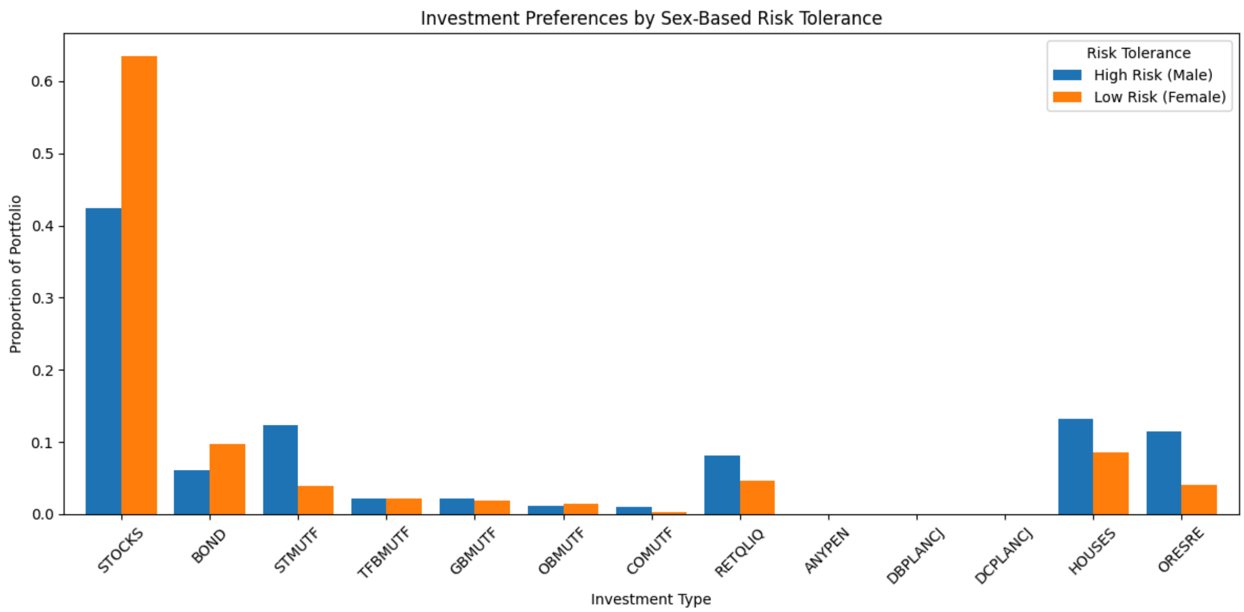
Overall, it's important to highlight to not rely on one demographic characteristic but a combination of all the factors mentioned above in order to better develop an accurate understanding of the relationship that different demographics of investors have with risk.

Part 2: How do preferences for investment instruments vary among high and low-risk tolerant clients?

Based on the work done by John E Grable and Ruth H Lytton to define which characteristics result in a lower vs higher risk tolerance, we decided to look at financial assets owned by each group. Our analysis draws on the Survey of Consumer Finances (SCF) 2022 dataset, we examined how preferences for different investment instruments vary among high and low-risk tolerant investors across various demographics. By segmenting the data based on factors such as gender, race, income, and education level, we aimed to identify distinct patterns in investment choices corresponding to varying levels of risk tolerance.

Our findings reveal distinct investment preferences between high-risk and low-risk tolerant investors. High-risk investors consistently allocate a larger proportion of their portfolios to assets with higher growth potential, despite greater volatility, most notably equities. Conversely, low-risk investors exhibit a clear preference for more stable, lower-yield instruments such as bonds. While this overarching trend is apparent across various asset categories, nuanced patterns emerge when examining specific demographic factors such as income, and education.

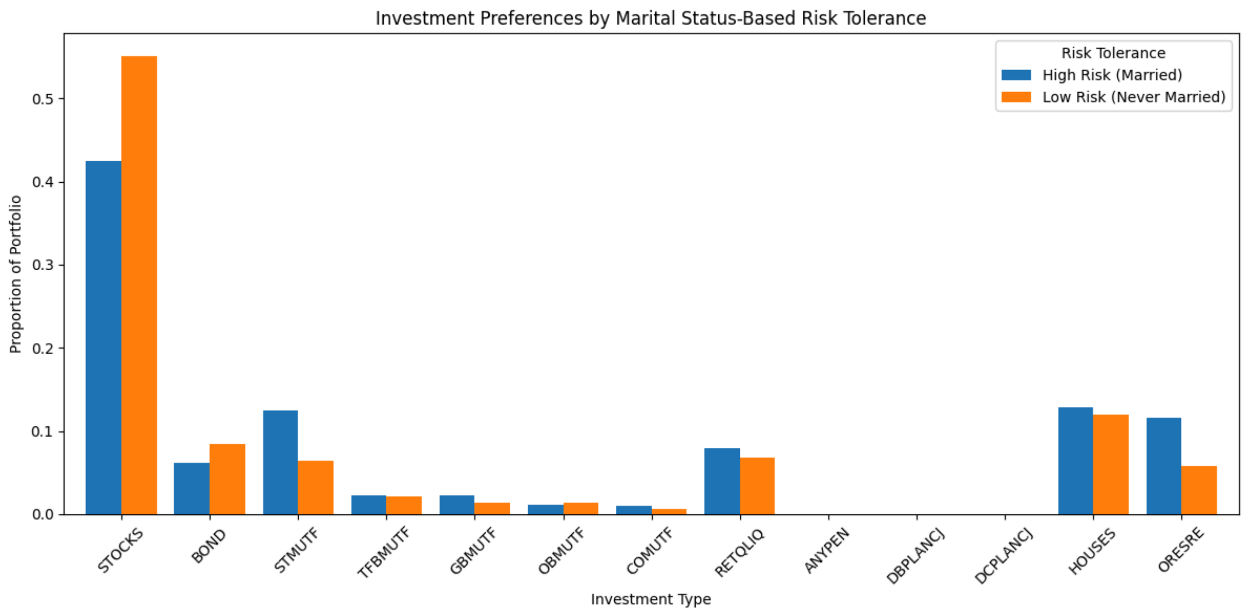
a. **Investment preferences by gender**



The chart shows clear differences in investment preferences by gender and risk tolerance. High-risk men allocate about 40% of their portfolios to stocks, while low-risk women allocate over 60%, making women 1.5 times more likely to favor stocks. High-risk men invest nearly twice as much in mutual funds (STMUTF) compared to low-risk women, while women allocate slightly more to bonds, reinforcing their preference for lower-risk assets.

Additionally, real estate investments (HOUSES, ORESRE) are more balanced across both groups, though high-risk men invest slightly more. The trends align with existing research: men favoring higher-risk, growth-focused assets like stocks and mutual funds, while women lean towards stability with bonds and conservative investments.

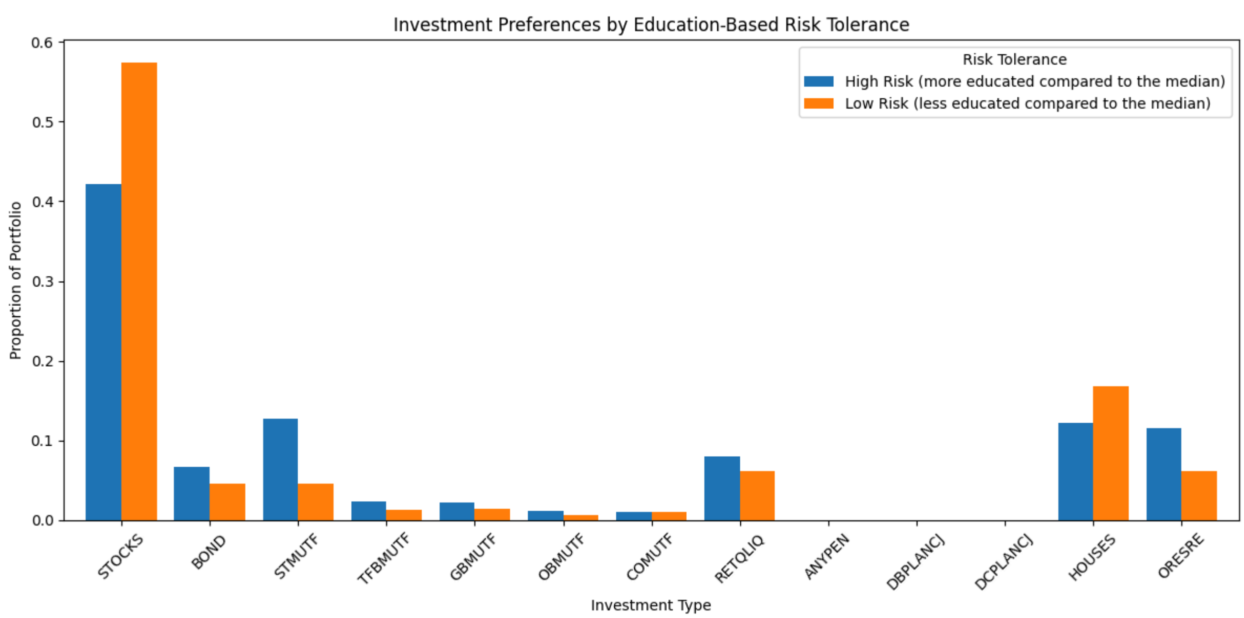
b. **Investment preferences by marital status**



The chart shows that never-married individuals allocate over 50% of their portfolios to stocks, about 25% more than married investors, suggesting higher risk-taking. Married investors allocate nearly twice as much to mutual funds (STMUTF), favoring diversification.

Never-married individuals invest slightly more in bonds, prioritizing stability, while married individuals allocate more to retirement assets (RETLQIQ) for long-term security. Real estate investments (HOUSES) are similar across groups, but never-married individuals invest significantly less in other real estate (ORESRE)

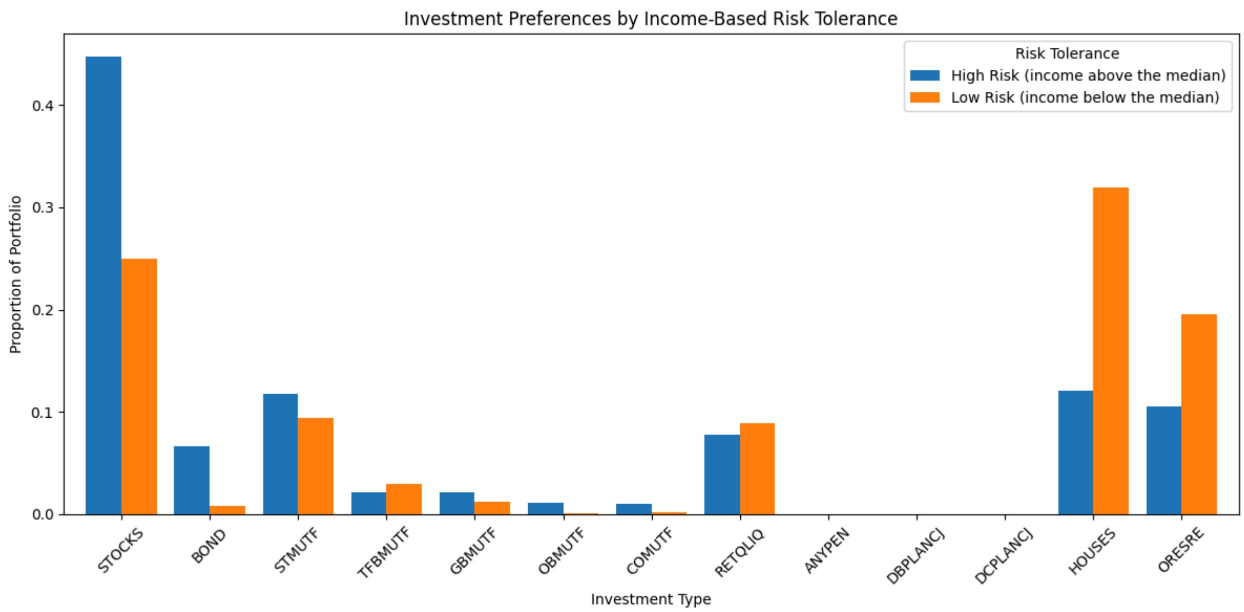
c. **Investment preferences by educational level**



The chart demonstrates that less-educated, low-risk investors allocate nearly 60% of their portfolios to stocks, about 30% more than their highly educated, high-risk counterparts, suggesting a heavier reliance on equities. More educated, high-risk investors invest nearly twice as much in mutual funds (STMUTF), favoring diversification over direct stock holdings.

Bond allocations are slightly higher among highly educated investors, while retirement liquidity assets (RETLQIQ) see greater investment from high-risk individuals, reflecting long-term financial planning. Less-educated investors allocate more to real estate (HOUSES, ORESRE), possibly viewing property as a more tangible or secure investment.

d. **Investment preferences by income level**



The chart reveals that high-risk, higher-income investors allocate over 40% of their portfolios to stocks, nearly twice the proportion of low-risk, lower-income investors, who allocate just over 20%. Higher-income investors also invest more in mutual funds (STMUTF), favoring diversification.

Conversely, lower-income investors allocate significantly more to real estate (HOUSES, ORESRE), with nearly 50% of their portfolios in housing compared to a much lower share among higher-income individuals. This suggests that lower-income investors prioritize tangible assets over financial markets. Additionally, bond investments are minimal for both groups, but retirement liquidity assets (RETLQIQ) are slightly higher for lower-income investors, possibly reflecting a focus on financial security.

Part 3: Are there specific groups of investors who are underserved despite having a high interest in high-risk products?

Some high-risk investors may be underserved by traditional financial offerings, which often emphasize low-volatility, long-term growth strategies rather than speculative, high-return investments. According to the World Economic Forum (2023), demand for alternative assets such as cryptocurrencies, venture capital, and thematic ETFs has surged among sophisticated investors, yet financial institutions have been slow to provide structured access to these products.

One underserved group includes high-income, financially literate investors seeking speculative investments. Research by the CFA Institute (2022) highlights that traditional wealth management firms continue prioritizing conservative asset allocations, leaving many risk-seeking investors without tailored high-growth options. Emerging market investors also face barriers, reports from the World Bank (2022) indicate that regulatory restrictions, lack of liquidity, and limited derivative markets prevent investors in developing economies from accessing structured financial products, often pushing them toward informal or high-risk alternatives. Additionally, self-directed investors and entrepreneurs, who often exhibit higher risk tolerance, may struggle to find growth-oriented investment products suited to their needs.

To address these gaps, wealth management firms could expand access to leveraged growth portfolios, structured investment products, and advisory services for high-risk investors. According to the International Monetary Fund (IMF, 2023), integrating structured equity options and derivatives into portfolios could help bridge the gap between demand for high-risk investments and available offerings.

Appendix

- **Appendix A**

Below is a concise mapping of the original SCFP 2022 dataset columns to shortened, more intuitive labels. The table also includes brief descriptions to clarify what each field represents.

STOCKS	Stocks	Represents holdings in publicly traded company shares.
BOND	Bonds	Denotes investments in corporate or government debt instruments.
STMUTF	Short-Term Mutual Funds	Mutual fund holdings focused on short-term debt securities.
TFBMUTF	Tax-Free Bond Mutual Funds	Mutual funds investing in municipal or other tax-exempt bonds.
GBMUTF	Government Bond Mutual Funds	Mutual funds investing primarily in government-issued bonds.
OBMUTF	Other Bond Mutual Funds	Mutual funds investing in a variety of bond types not classified elsewhere.
COMUTF	Common Mutual Funds	General mutual funds that may include a mix of equities, bonds, or other assets.
RETQLIQ	Retirement Account Balance	Total balance in retirement accounts (e.g., 401(k), IRA).
ANYPEN	Any Pension	Indicator or amount for any type of pension plan.
DBPLANCJ	Defined Benefit Plan (Current/Joint)	Defined benefit pension plan for current or joint accounts.

DCPLANCJ	Defined Contribution Plan	Defined contribution retirement plan (e.g., 401(k), 403(b)) for current or joint accounts.
HOUSES	Houses	Value or ownership of primary residence(s).
ORESRE	Other Real Estate	Ownership or investment in real estate other than primary residence (e.g., rental properties, land).

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