

Intelligence – Does it Matter in Investing?

This is a subject that comes up from time to time. It has also been the subject of research as reported in the December 2011 issue of *The Journal of Finance*. The findings are controversial to say the least. Taking account of income levels and education, the authors of the study found that investors with relatively higher IQ tend to diversify their portfolios more than do those with lower IQ scores. They also tend to invest more heavily in the stock market. However, they do not tend to invest in any old stock. They tend to focus on small capitalization stocks that have historically beaten the broader market. They also tend to focus on stocks with high book values in relation to price. This results in a situation where higher IQ investors building portfolios with a superior risk-return profile.

The study was carried out in Finland, a country with conscripted military service – so they had IQ scores and a wealth tax so that investment portfolios were reported to the government. This greatly facilitated the comparison of IQ scores and investing habits.

The authors of the study did not find that investors with high IQ scores had a corner on investing skills. However, what seemed to stand out was the superior investing skill of the high IQ group. In other words they did little more than to follow the proven sound rules for successful investing.

You may ask why IQ mattered here. Was it not common sense to invest in a broadly diversified portfolio or to have an adviser do it for them? The other timeless rule of investing is to lean heavily to stocks. Yet only about half of Americans (and undoubtedly Australians) invest heavily in stocks, especially in the volatile markets of recent times. This posed the question of whether the average investor lacks trust in their advisers. Either that or they lack the confidence in whom to trust. Indeed there was earlier research in the US that suggested many households fail to invest heavily in stocks out of fear they might be misled. Indeed, knowing whom to trust is a basic aspect of intelligence. This involves social intelligence or the ability to put standard investment advice and strategies into effect.

Above all it seems to suggest that a higher intelligence is directly related to the ability to rise above the angry reaction to what happens on Wall Street, which is often partly justified, while being largely unfounded and therefore exaggerated.

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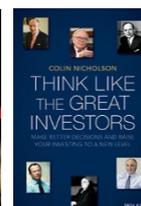
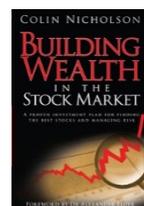
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