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The Stockholding and Household Wealth Connection

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Introduction

In 2013, Americans' wealth reached a historical high due to an extended surge in the value of stocks and housing. Even adjusted for inflation, U.S. household net worth (the value of real estate, stocks, and other assets less debts and other liabilities) hit a new record (Shah, 2014). These statistics imply that Americans made substantial progress repairing the damage caused by the mortgage crisis and the great recession, which lasted from December 2007 through June 2009.[1] Yet, the recovery was not equally experienced by all U.S. households, as there was limited wealth accumulation for most middle- and lower-income Americans.

Propelling most of the 2013 gains was a massive rally in the U.S. stock market. The broad Standard & Poor's 500-stock index rose 30 percent, with the value of stocks and mutual funds owned by U.S. households rising to $5.6 trillion in 2013 (Shah, 2014). As affluent Americans are more likely to have stockholdings, the increase in stock prices disproportionately profited these households. Household holdings of stocks and bonds as a share of overall net worth rose to 35 percent – the highest level since 2000 (Shah, 2014). Thus, as wealth increased, it was increasingly going to the wealthier households. The disproportionate share of wealth accumulation accruing to already affluent households promotes a two-tiered U.S. recovery that could further exacerbate wealth inequality in the U.S. and highlights an important connection between wealth and stockholding.

Household Wealth and Stockholding

Portfolio choice and stockholding are important for both distributional welfare issues and broader financial market effects (Campbell 2006). Consequently, it is imperative that households appreciate how stockholding choices influence economic advancement and wealth building, particularly during economic recovery periods and prosperous economic times.

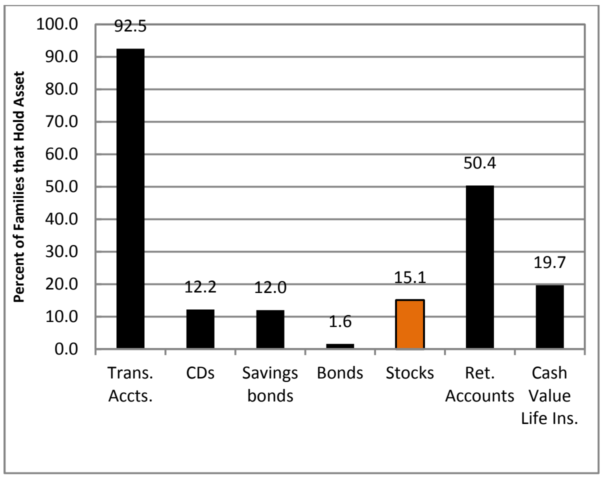
There are a few essential aspects of wealth accumulation. Hao (1996) shows that wealth accumulation depends on saving behavior, inheritance, and wealth transfers which are ultimately determined by the family background and the socioeconomic and demographic characteristics of the parents. Over a lifetime, about 30 percent of American households receive a wealth transfer and these transfers account for close to 40 percent of their net wealth (Wolff and Gittleman, 2011). Additionally, it has been determined that net wealth is influenced by the number of years an individual has been consistently investing and the proportion of funds (on average) allocated to higher return investments such as stocks.[2] However, most households do not engage in

[1] National Bureau of Economic Research – U.S. Business cycle Expansions and Contractions (http://www.nber.org/cycles/cyclesmain.html)

[2] www.hussmanfunds.com

behaviors that contribute to this goal. With regard to U.S. households, the majority have no equity related investments. The 2010 Survey of Consumer Finances shows that less than 16 percent of families held stocks (See Figure 1).

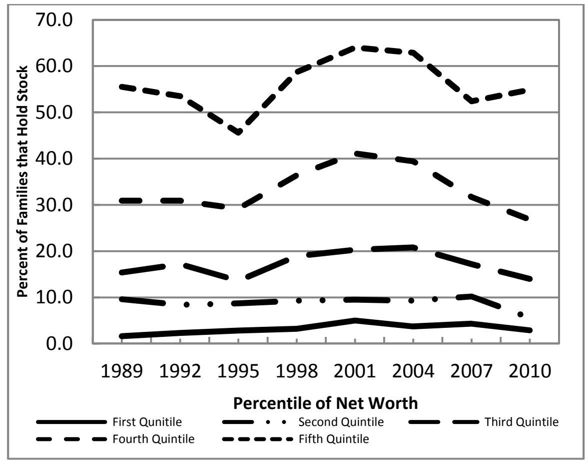
Figure 1: U.S. Asset Holdings 2010[3]



This is not a recent phenomenon. Historically, U.S. stock market participation consistently has been low, with fewer than one-third of U.S. households holding stock. This proportion has been found to be remarkably stable over time and across various data sets (Bogan, 2008).

Stockholding behavior also is concentrated among higher net worth households. Figure 2 shows the percentage of U.S. families holding stock by net worth quintile. From Figure 2, one can see that the highest wealth quintile households have the highest percentage of stockholding. Generally, over 50 percent of the highest wealth quintile households hold stock while less than 10 percent of the second wealth quintile households hold stock and less than 5 percent of the lowest wealth quintile households hold stock.

Figure 2: Household Stockholding by Net Worth Quintile (1989 – 2010)[4]



Beyond the effects of bequests and wealth transfers, there could be intergenerational persistence in wealth levels due to intergenerational links in stockholding. Chiteji and Stafford (1999) find that a young family's likelihood of owning stocks and transaction accounts is affected by whether parents held these financial assets. Hence, households need to understand the specific elements of family structure that have been linked to stockholding and thus to household wealth.

The Role of Education and Financial Information

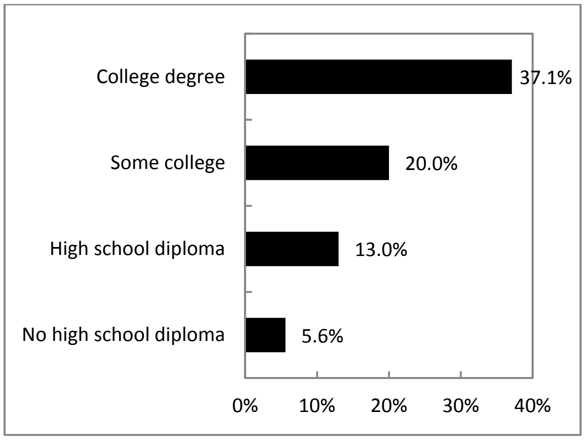
There is a strong connection between stockholding and education level. Households

[3] 2010 Survey of Consumer Finances

[4] Survey of Consumer Finances – 1989 to 2011

in which the household head has a college degree are much more likely to hold stock than other households (See Figure 3). Over 37 percent of households with a head with a college degree hold stock. Less than 6 percent of households with a head without a high school diploma hold stock.

Figure 3: Stockholding by Household Head Level of Education[5]



In addition to general education levels, specific financial information also influences stockholding behavior and thus wealth levels. Bertaut (1998) asserts that most households persistently invest in riskless assets but not stocks because they estimate information required for market participation to be costly relative to expected benefits. Bogan (2008) finds that lowering transaction and information costs significantly increases stock market participation. Guiso et al. (2003) also find support for the hypothesis that information-related barriers to entry exist for household stockholding.

[5] 2010 Survey of Consumer Finances

Conclusion

The link between wealth and stockholding has been well-established. The fact that lower financial information costs and increased financial education significantly increase stockholding, suggests another means to influence long-term household wealth levels and ameliorate wealth inequality.

Most of the financial information that households receive comes directly from the financial sector and hence many households are justifiably skeptical. The credibility of the sources of financial information is an important factor in individual and household financial information use. This illuminates a need for more third party information campaigns. Additionally, increased government regulation of financial product information disclosure requirements, financial product complexity, and related fees is needed (Célérier and Vallée, 2014). Since a large inheritance is not going to be part of the financial future of the majority of middle- and lower- income households, policies designed to increase credible information sources and education are vital to facilitating wealth accumulation through stockholding and thus reducing wealth inequality. ~

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