The contested significance of financial expertise in predicting short- and long-term risk and return on the stock market

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Abstract

This study investigates whether the influence of financial expertise on stock investors' ability to predict risk and return is contingent on the length of the forecast horizon. In a quasi-experimental design, stock market professionals (N1=63, N2=36), private shareholders (N1=155, N2=172) and students (N1=124, N2=90) twice provided their short- (3-month) and long-term (2-year) risk and return predictions on stock indices. The results show that in general, experts did not outperform students or private shareholders in their return predictions. However, the level of financial expertise positively influenced the accuracy of risk predictions. An interaction effect between financial expertise and the length of the forecast horizon suggests that more knowledgeable and experienced investors performed better in the long term compared to the short term than inexperienced investors did. In general, the results imply that lay people have surprisingly little to gain from seeking advice from financial experts. If their investment horizon is short, they might as well rely on the efficiency of the market and their own luck. However, for lay people with a long investment perspective, financial expertise may be advantageously in the purpose of controlling investment risks and improving risk-adjusted returns

Keywords: financial expertise, stock market predictions, overconfidence, forecast horizon