

From Physician's Financial News

## Trade more. Invest more. Get more. Really?

By Shirley M. Mueller, MD    Published on March 24, 2008    |    [\[ Email \]](#) - [\[ Print \]](#)

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The cover of a recent booklet from a major brokerage firm says, “Trade more. Invest more. Get more.” The model on the cover, suggestively endorsing this concept, is in the prime of life. Some would say he is handsome. His face looks friendly, appealing and almost academic. Certainly, most men would like to identify with him. If they did and followed the advice, “Trade more, Invest more,” would they “get more”?

### *Trade More*

Finance Professors Brad Barber and Terrance Odean from the University of California, Davis published a February 2001 paper directed at this question in *The Quarterly Journal of Economics*. It was entitled [\*Boys will be Boys: Gender, Overconfidence, and Common Stock Investment\*](#). The researchers knew that theoretical models of financial markets are built on the assumption that some investors are overconfident.

This suggested to them that overconfident investors may trade more than those that are less confident. Barber and Odean tested this prediction by partitioning investors on the basis of a variable that provides a natural proxy for overconfidence—gender. Psychological research has established that men are more prone to overconfidence than women. Thus, models of investor overconfidence predict that men will trade more and perform worse than women because of this (trading is expensive).

The researchers analyzed common stock investments of men and women from February 1991 to January 1997 from over 35,000 households at a large discount brokerage firm. Single men earned an annual risk-adjusted net return of 2.3% less than that earned by single women. Married men earned an annual risk-adjusted net return of 1.4% less than married women (both approximated above).

Barber and Odean attributed this to men trading more. Single men trade 67% more than single women. Married men traded 45% more than married women (Both approximated above). The professors concluded that because men are overconfident, on average, they overtrade assuming that they can pick winning bets that will more than cover their trading costs.

Wrong. Women, who adapt more of a “buy and hold” strategy, do better.

Trading costs are high. They include commissions and bid-ask spread. We're all familiar with commission that brokerage firms charge. It is the cost for the transaction, which goes in part to pay the broker who executes your order. The cost of the commission is apparent to you because it is written on your stock trade confirmation. The average round trip trade at the discount

brokerage firm where Odean and Barber obtained their data cost about 3% in commissions (for trades over \$1,000). A round trip trade includes both a sale of the stock and then a repurchase of a different stock (or the reverse). If trades under \$1,000 were included, the round trip commission costs would have been higher, 5%.

The other trading cost, the bid-ask, is for the supplier that provides the stocks to the brokerage house. The stocks you buy are marked up; those you sell are marked down. This means you do not pay the actual price of the stock if you are buying. You pay more. Likewise, you receive less than the quoted price if you are selling. The middle man gets the remainder—a profit for his trouble. The cost for the spread in Barber and Odean's study was 1% for a round trip transaction.

You are not aware of the spread when you make your trade because it is hidden in the price of the stock. By this I mean that if you traded \$10,000 worth of stock, and the spread for a round trip transaction were 1%, you would have received \$9,900 worth of stock for your \$10,000. Yet, you would be charged \$10,000. The 1% or \$100 difference goes to the middle man called the market maker.

Therefore, for every round trip transaction using \$10,000 worth of capital, the investors in Barber and Odean's study paid \$100 to the market maker and \$300 to the brokerage firm for commission.

Transaction fees of \$400 out of \$10,000 may not sound like a lot of money. However, if many trades are made, principal quickly diminishes to finance the spread and the commission. For example, let's say 10 round trip trades were made in two days with \$10,000 worth of capital. Three hundred dollars per trade for the commission times 10 equals \$3,000. The cost of the spread is \$100 times 10 or \$1,000. In order to pay for this, the investor must make \$4,000 return just to cover the cost of the spread and commission for the 10 trades. If the investor didn't make at least \$4,000 she (or more likely he) would lose money. An old joke is that a broker would rather take out his own appendix with a rusty spoon than tell a client what the total fees for a buy and sell really are.

### *Invest More*

Yes; this would work if it weren't traded away.

### *Get More*

Who really gets more? If a physician-investor trades a lot more, it will likely be the brokerage firm that is getting more. The ad is self serving for the brokerage firm rather than the investor. Is that any surprise? Still it appeals to one of our most basic instincts, **HOPE OVER REALISM**. Although this characteristic may be helpful in other areas of life and even save us from feeling down or depressed, it does not serve us well when we invest our money. **REALISM OVER HOPE** is a better option here.

## About Shirley M. Mueller, MD

Dr. Shirley Mueller is a physician turned financial consultant and investment educator. She teaches others how to invest their own money using a Noble Prize-winning financial strategy. Her fee is hourly, not a percentage of assets. She welcomes comments at [ShirleyMMueller@MyMoneyMD.com](mailto:ShirleyMMueller@MyMoneyMD.com). For more information, visit her website at [MyMoneyMd.com](http://MyMoneyMd.com)

