Q: My wife said she read something about women being potentially better investors than men. I told her this is nonsense. Your thoughts?

A: I'm sorry to tell you, but according to well-regarded research, your wife is correct. What she probably read is a reference to a classic behavioral finance study, published in 2000. This study concludes that women tend to be better investors than men. The apparent reason for this is that they lack something that often hurts men's investing performance: overconfidence.

The study, by Terrence Odean, now with the University of California at Berkeley, and Brad Barber of the University of California at Davis, was published in the prestigious Quarterly Journal of Economics and still receives a lot of attention.
After studying the investment returns of American men and women in the 1990s, the researchers found that women outperformed men by about 1 percent annually, which is actually a big difference. After examining the trading patterns of men and women, the researchers found that men traded 45 percent more than women.

The performance gap between genders was even greater between single women and single men. Single men traded 67 percent more than single women did, allowing single women to outperform single men by 1.44 percent a year.

As heavy trading tends to reduce returns, the researchers concluded, this is a major factor accounting for the difference in men's returns versus women's.

After testing several theories, Odean and Barber concluded that men tend to be more overconfident than women and that this overconfidence prompts them to trade more, setting them up for lower returns.

Not surprisingly, research is underway on the effects of testosterone - something men have and women don't - on investing performance.
Regardless of your gender and your investing preferences, there are things you can learn from the researchers' findings:

- Don't trade habitually. Instead, establish a longterm investment portfolio and stick with it, rebalancing your portfolio when necessary to restore the original proportions of different types of investments.
- Resist the urge to buy stocks that are supposed to be hot. You'll most often just be buying what is already priced high. Instead, stick to your long-term plan and resist the temptation to buy stocks that are in the headlines. If a stock has recently soared, its future returns are much more likely to resemble its past long-term average returns.
- Don't make your overall portfolio too complicated. Instead, just cover the major asset classes and avoid the dangerous, exotic stuff. Trading too much tends to be the practice of many people who invest in individual stocks or actively managed mutual funds (where professional managers do lots of buying and selling) rather than passively managed funds. The best types of passive investments are institutional asset-class funds, which track specific asset classes, such as large- or small company stocks, and investment-grade bonds, which are safe. For those without access to these institutional funds, low-cost, generic index funds that track major indexes (for example, the S& P 500) can be a good solution.

Reams of objective academic evidence show that over the long term, these types of low-cost funds regularly deliver better returns than buying and selling individual stocks or paying investment managers to do this for you. Investors who own a balanced portfolio of low-cost, passively managed funds can sit back and capture the returns of the overall market rather than foolishly attempt to beat it.

When you think about it, active investing - attempting to outperform the markets - is really driven by overconfidence. Buying and selling stocks is akin to gambling where the odds are significantly stacked against you - unlike harnessing the returns of the market by investing

passively through asset-class funds or index funds.
Historically, the stock market has tended to be up annually nearly 70 percent of the time. So, regardless of your gender, capturing the long-term average returns of the overall market can provide you with superior returns. And above all, this can reduce overall risk.
