

## How Well Do Individuals Assess Their Own Risk Tolerance? An Empirical Investigation

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### Abstract

The purpose of this study was to test how accurately individuals judge their own level of financial risk tolerance, and to determine if self-assessed financial risk tolerance is predictive of risk-taking investment behavior. Using a sample of Internet risk assessment survey respondents ( $N = 1,710$ ), this study employed correlation analyses, ANOVA, and hierarchical regression to conclude that individuals do a reasonably good job at assessing their own level of financial risk tolerance, if a risk item, such as the one used in this study, is provided to clients.

Self-assessed financial risk tolerance was found to be a statistically significant predictor of general financial risk tolerance, cash holdings, and equity holdings, both by itself and when analyzed using control variables. The amount of variance explained by self-assessed risk tolerance, by itself, ranged from 2% for cash holdings to 27% for general risk tolerance. The relative strength of the variable, as measured by standardized regression coefficients, remained steady throughout each regression model. The results from this study lend support to the theoretical hypothesis that individuals can assess their own risk tolerance level to some extent.

Other variables that showed consistent significance levels across the analyses included age and income. Age was negatively associated with risk tolerance and cash holdings, but positively related to equity holdings. A curvilinear effect was noted between age and risk tolerance as well. Income was shown to be positively associated with equity holdings and negatively related to cash holdings. Curvilinear effects were noted between income and equity holdings ( $\cap$ ) and income and cash holdings ( $\cup$ ). Overall, the three hierarchical regression blocks used were able to explain approximately 30% of the variance in risk tolerance, 17% of the variance in cash holdings, and 25% of the variance in equity holdings.

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### Endnotes

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