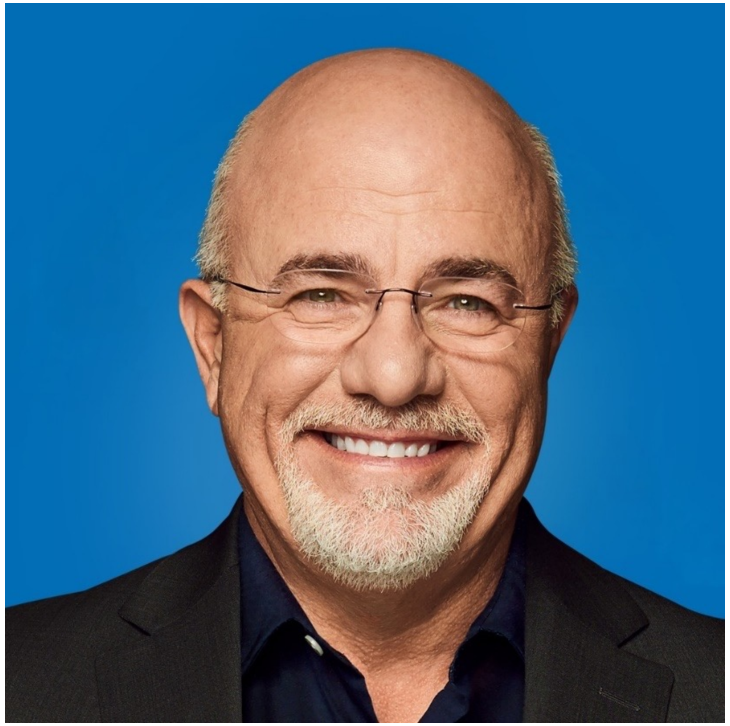
Yale SCHOOL OF MANAGEMENT

Popular Personal Financial Advice versus the Professors

James J. Choi

Popular financial advice

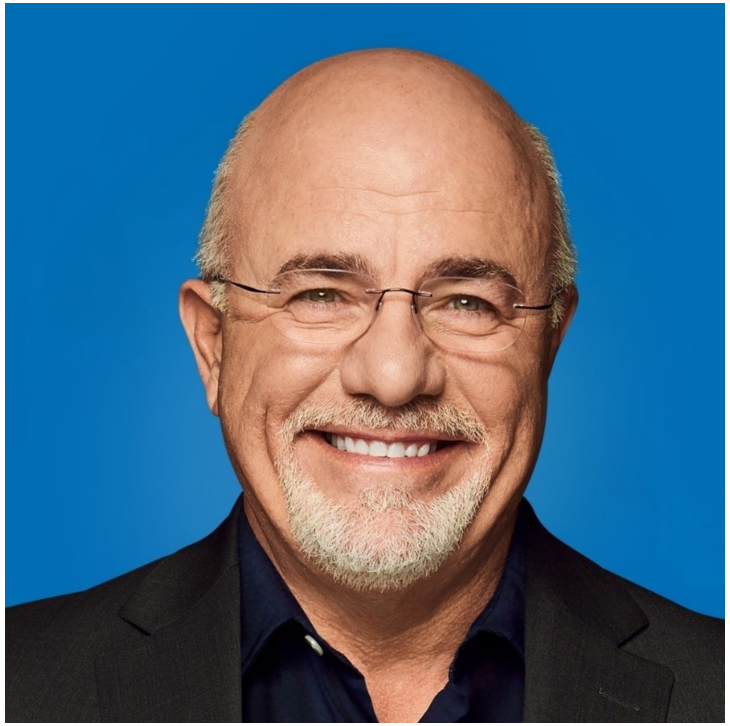


Dave Ramsey

Suze Orman

Jack Bogle

Popular financial advice



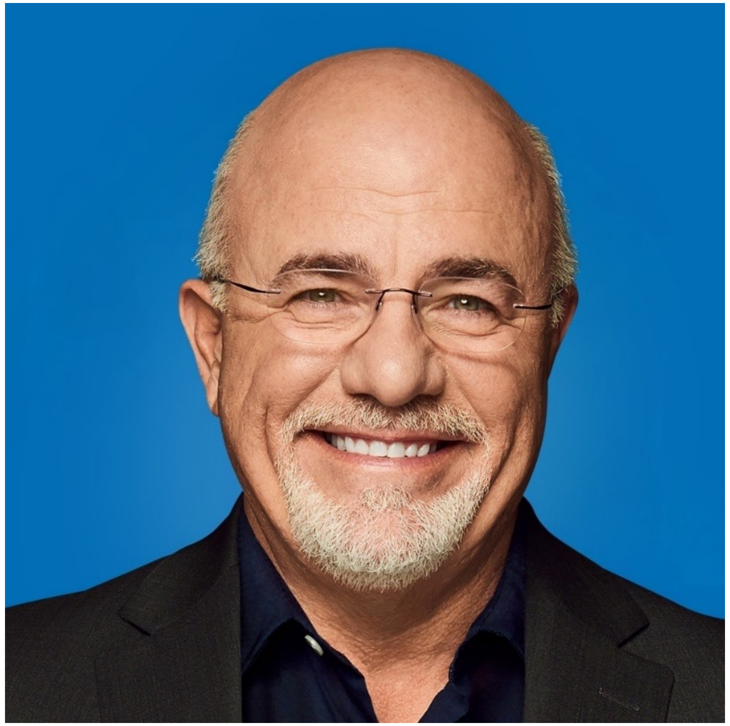
Dave Ramsey

1.5 million: Copies sold of book *Total Money Makeover* since 2013

18 million: Radio show listeners per week

647 million: Views of uploads of radio show to YouTube

Popular financial advice



Dave Ramsey

Chopra (2021):

Exposure to Ramsey's radio show reduces household retail spending by $\geq 5.4\%$

Felix Chopra, 2021. "Media persuasion and consumption: Evidence from the Dave Ramsey show." Working paper.

Why is popular advice interesting?

- May help us understand why actual household financial choices are made
- May be second-best in a way that illuminates constraints faced by individuals
- May contain valuable normative insights that economists have overlooked
- Jumping-off point for teaching standard economics

Sample selection

- 50 most popular personal finance books on website Goodreads as of May 2019
  - Ranked by number of users who placed book in their virtual "personal finance" shelf

- 3 books contain no advice for topics I focus on

- Final sample: 47 books by 35 author teams

Topics covered in paper

- Asset allocation
  - Equity share
  - Market timing
  - Dividends and interest
  - Equity styles
  - International diversification
  - Active vs. passive
- Savings
  - Over the lifecycle
  - Wealthy hand-to-mouth
- Non-mortgage debt management
  - Debt repayment
  - Co-holding
- Mortgage choices

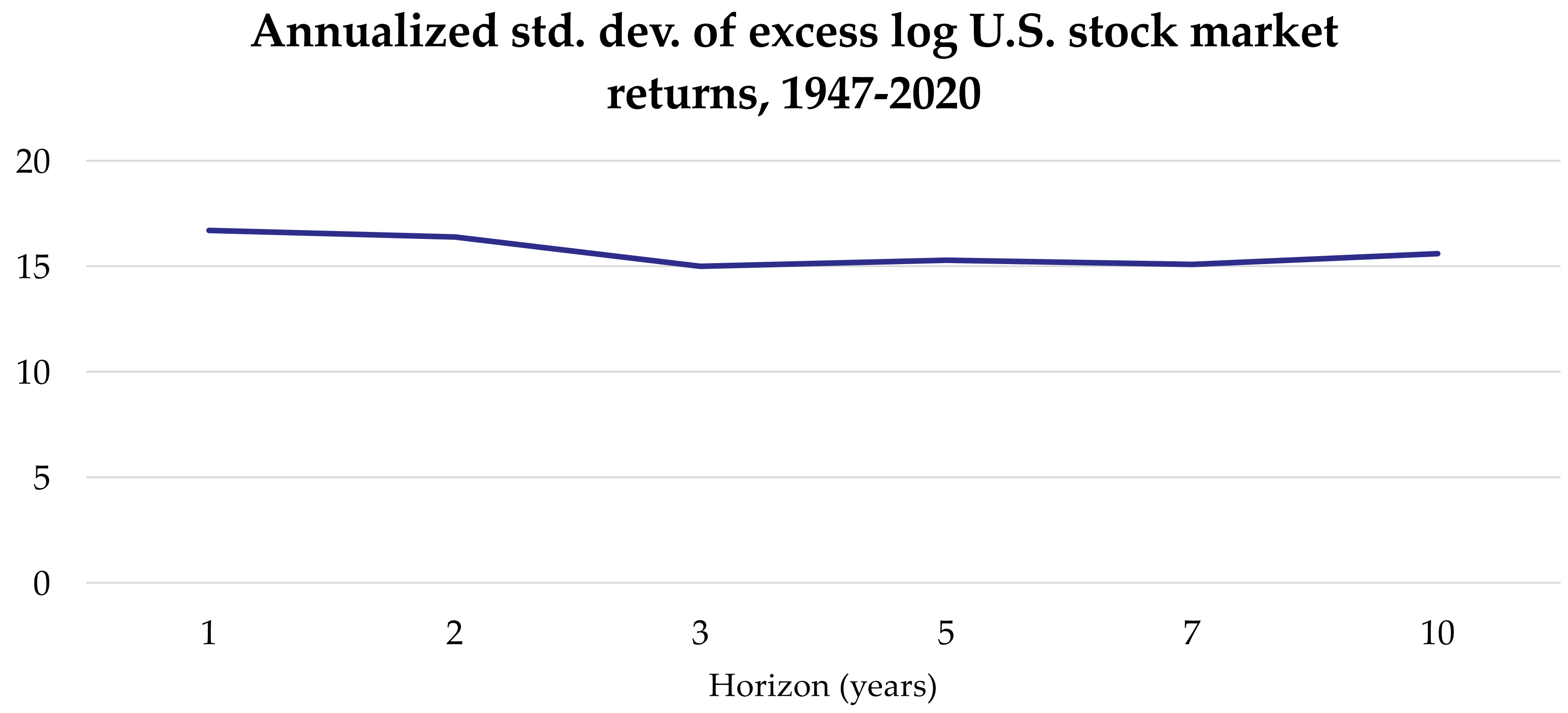
Investment horizon is king

31 books (69%) say that stocks become less risky as holding period increases

– Dave Ramsey: stocks "are **lousy short-term investments** because they go up and down in value, but they are **excellent long-term investments** when leaving the money longer than five years" because "one hundred percent of the fifteen-year periods in the stock market's history have made money."

Empirical evidence

Campbell, Lo, and MacKinlay (1997): “there is little evidence of mean reversion of long-horizon [stock market] returns”



Benchmark economic theory

- Economists have a theory of optimal *consumption*
  - Optimal savings rate is whatever happens to be the difference between income and optimal consumption

- Theory's prescription: Smooth consumption

- Hump-shaped income over lifecycle → low/negative savings rate when young, high savings rate in midlife, negative savings rate during retirement

Against consumption smoothing

David Chilton:

“Do not heed that advice… it seldom works in the living room. First, costs have a funny way of never stabilizing. Second, most people aren’t going to be able to transition from setting aside nothing to being supersavers at the flip of a switch. Psychologically, that’s just not realistic. Finally, I can’t get the numbers to work anyway.”

Basic principle of optimal debt prioritization

Prioritize paying down debt with highest interest rate

Popular authors' prioritization

- 10 books (43%) recommend prioritizing highest-interest debt
- 9 books (39%) recommend debt snowball
  - Prioritize paying off smallest-balance debt
  - Dave Ramsey: "People sometimes say, 'But Dave, doesn't it make more sense mathematically to pay off the highest interest rates first?' Maybe. But if you were doing math, you wouldn't have credit card debt, would you? This is about behavior modification. You need some quick wins or you will lose steam and get discouraged… every time you cross a debt off the list, you get more energy and momentum…"

Books for my course