

Invitation

You are cordially invited to the public defence to obtain the academic degree of

DOCTOR OF ECONOMICS

by Mariachiara Tedde

Financial Literacy and Investor Trading Behavior: The Impact of Overconfidence, Warning Signals and Financial Attention

Supervisor:
Prof. dr. Koen Inghelbrecht

Monday, 2 December 2024 at 17h

in 'Faculteitsraadzaal', campus Tweerkerken, Tweerkerkenstraat 2, 9000 Ghent

Please confirm your attendance no later than 22 November by email to

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EXAMINATION BOARD

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Abstract

This doctoral dissertation consists of a general introduction and four chapters, investigating how investors' financial literacy influences their trading behavior. The main aim is to examine the impact of investors' overestimation of their financial literacy, reflecting overconfidence, on their trading decisions. The analysis will consider the influence of overconfidence on investor demand, performance, and broker profits, underscoring the need for stronger regulations to mitigate the potential adverse effects of overconfidence on financial markets. Both theoretical and empirical findings reveal that overconfident investors tend to trade excessively, exceeding the activity of rational investors, incur higher transaction costs, and often ignore signals indicating their low financial literacy. These investors also achieve poorer performance as their financial attention increases.

The first chapter investigates the link between the trading behavior of investors and their level of financial literacy, specifically analyzing how investors trade when they are overconfident about their financial literacy and tend to overestimate it. Overconfidence is measured by the MiFID (Markets in Financial Instruments Directive – Directive 2004/39/EC) test scores. The results suggest that overconfident investors exhibit a higher demand for risky assets and face higher transaction costs, thereby benefiting brokers. Additionally, it is shown that the stress resulting from a mismatch between MiFID test scores and the subjective financial literacy mitigates the impact of overconfidence.

The second chapter studies the impact of the MiFID-mandated warning signal on curbing excessive trading behavior among financially illiterate investors. According to MiFID regulations, brokers must warn investors when a financial product is deemed inappropriate. The results prove that an effective warning signal can reduce investors demand for risky assets, thereby lowering transaction costs and, to some extent, improving investor performance. However, the study also demonstrates that overconfidence in financial literacy can undermine the effectiveness of the signal.

The third chapter examines how investors' financial attention, alongside varying levels of financial literacy, influences their performance. The findings indicate that when financial attention is combined with high financial literacy, it enhances performance. In contrast, financial attention combined with low financial literacy has a negative impact. These effects are even more pronounced for investors who are overconfident in their financial literacy.

The last chapter draws some general conclusions, underlining that investors' overconfidence, especially if combined with low financial literacy, can have a negative impact on investors' behavior and may become an element of risk that can lead to financial losses. From this point arises the need for stricter rules in designing the MiFID questionnaire, in order to make it a more trustworthy tool to grade investors' financial literacy, and in designing the warning signal, in order to make it more effective.

Curriculum vitae

Mariachiara Tedde (born in Sardinia) holds a Master degree in Economics (2012, University of Sassari, Italy). She joined the Department of Economics at Ghent University (Faculty of Economics and Business Administration) in 2018 as a PhD student. Her research has been presented at national and international conferences, including the Belgian Financial Research Forum (2023 and 2024, Brussels), the Research in Behavioral Finance Conference (2022, Amsterdam), and the Behavioural Finance Working Group (2023, London). The first chapter of her dissertation has been published in the *Journal of Economic Behavior and Organization* and the second chapter is currently under revision for the *Journal of Banking and Finance*.