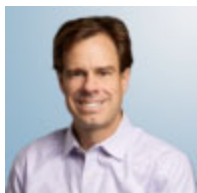


Investors Are Too Pessimistic. Financial Advisors Are Not.

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MarketWatch Blog by [Geoffrey T. Sanzenbacher](#)



[Geoffrey T. Sanzenbacher](#) is a columnist for [MarketWatch](#) and a professor of the practice of economics at Boston College. He is also a research fellow at the Center for Retirement Research at Boston College.

But Do Advisors Help their Clients See the Bright Side?

I'll admit, I've always been a skeptic of the financial advising industry. In fairness, it might be because for my entire 20s I was living on a graduate student stipend in the not-so-cheap city of Boston. And I spent much of my 30s recovering. Questions like "how many packs of Ramen can one safely eat per week?" and "rent is how much!?" rarely interest financial gurus. But even as I've gotten older and had more money to save, I've tended to lean on index funds and my own know-how. Plus, as I wrote last month, [target date funds and inertia](#) do a pretty good job of getting many people onto a reasonable glide path as they approach the end of their careers.

So, when I saw a [recent study](#) from my colleagues at the [Center for Retirement Research at Boston College](#) on financial advice, I tried to keep an open mind. The study explored two questions. First, what are the stock allocations recommended by financial advisors? Second, does this advice affect their clients' investment behavior? (This research is part of a broader initiative conducted in partnership with Jackson National Life Insurance Company.) These questions are important – market risk is a crucial consideration for people relying on financial assets in retirement. And even

though perhaps **a quarter of Americans** use financial advisors, the academic literature is unclear about advisors' suggestions around risk and how it affects their clients.

As a skeptic, I figured the answer to the first question was that advisors recommend assets with big commissions. And as a teacher, I figured the answer to the second question was that a few clients listen to the advice and the majority ignore it. Sigh. But, in my open-mindedness, I kept on reading. To answer those two questions, the researchers surveyed both financial advisors and investors. On the advisor side, the sample included 400 advisors with at least 3 years of experience, \$30 million in assets under management, and 75 clients. For investors, the sample included 1,016 individuals ages 48-78 with at least \$100,000 in total investable assets. Unfortunately, the surveys do not link advisors and clients, but the researchers attempted a weighting methodology to compare advisors' advice to investors' decisions.

On the first question, the survey of advisors showed considerable variation in the recommended stock allocation and thus in risk. For a baseline client, the average recommendation was a 48-percent allocation to stocks, but with a large standard deviation – 18 percent. So, the researchers wondered what drove this variance. One of the things that they found initially fueled my skepticism even more – advisors who relied on fees calculated as a percentage of assets recommended higher allocations to stocks. This makes sense if advisors are just trying to maximize their fees, since stocks will have a higher average return but with more downside risk. Then again, I reminded myself – trying to keep that open mind – the advisor only gets those higher fees if they make their clients more money. As long as the advisor is respecting the wishes of their clients with respect to risk, seeking higher returns is hardly a bad thing.

So, my skepticism was reduced when I saw that advisors were actually very sensitive to the risk preferences of their clients – they didn't just recommend lots of stocks all the time. For clients with a lower risk tolerance, advisors only recommended 30 percent of assets be allocated to stocks, more than a standard deviation below the baseline. Advisors' decisions were also shaped by their own preferred strategy – those seeking to maximize total returns chose more stocks while those targeting an income floor recommended fewer. It is obvious that much more is going on here than simple self-interested advice.

OK, so how does this advice influence clients? Well, it turns out that most investors would prefer to hold fewer stocks than in a theoretically optimal portfolio, especially prior to retirement. The survey of investors found that for pre-retirement savers, their preferred stock allocation fell well below even the most conservative recommended glide path based on economic theory. Essentially, investors want to accept too little risk and, in doing so, give up returns. Advisors seem to help offset this effect. Of the investors who said that their advisors' advice changed their behavior, 60 percent said that it shifted them towards more risk. This shift is almost certainly a good thing, given many investors' lower-than-optimal risk tolerance and advisors' more rational views.

In the end, my colleagues' study alleviated some of my skepticism of advising. Given many investors' overly cautious approach to risk, it seems that having someone give a helpful nudge towards a bit higher stock allocation is useful. Maybe as I get further from my Ramen days and closer to retirement, I too will think of getting a bit of help.