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Heartache and less rational decision-making after parent's death

Johan Sulaeman

"Death leaves a heartache that no one can heal."

Bereavement, the grief associated with the death of a loved one, is widespread. In Singapore, there were almost 20,000 deaths in 2015, an increase of 2.4 per cent over 2014. With an ageing population, bereavement will become an all too common life experience.

The loss of a loved one can have a profound effect at the workplace as psychological studies document that grief can significantly affect people's emotion and compromise their decision-making skills.

However, the economic consequences of bereavement are hard to assess, due to the lack of data and bereavement's "hidden" nature.

Because bereavement is a private matter, some organisations do not understand its impact and have even fired bereaved employees for their seeming lack of productivity. One report estimates that hidden grief costs American companies more than US$75 billion (S$105 billion) annually. At the National University of Singapore Business School, I worked with research collaborators in the United States to quantify the effects of bereavement on employee performance. We focused on money management because there is a lot at stake riding on the decisions made by professionals in this industry. One wrong decision can cost clients and investors millions.

The US has the largest and arguably the most sophisticated fund industry. Its mutual fund industry stood at US$15 trillion, with nearly 265 million shareholders in 2013.

We used data from various sources to identify fund managers in this industry, their demographic characteristics and some details of their parental death.

Our focus was on fund managers who had lost a parent while managing equity funds. The sample size was 205 fund managers, managing at least one fund, with parental deaths from 1999 to 2013.

Specifically, we measured fund manager's performance using fund alpha – the superior performance relative to their investment risks – in three distinct four-month periods: the pre-event period of three to six months before the parental death; the "event" period consisting of two months prior to and after the parental death; and the post-event period.

We found strong evidence that parental deaths were associated with substantial declines in fund performance, both around and following the parental-death event.

An actively managed fund whose manager experienced filial bereavement had an average decline in fund alpha of 1.1 percentage points over the four-month event window surrounding the parental death, relative to their own performance in the pre-event period.

We also examined the performance of index funds. Unsurprisingly, index funds managed by bereaved managers did not experience any decline in performance.

As managing index funds involves mostly passive decisions, the decline in performance associated with parental deaths of active fund managers is likely due to their reduced ability to perform the necessary cognitive tasks for making difficult investing decisions.

Not only did active fund performance decline in the short run, it persisted for up to 12 months, suggesting a longer-term negative impact of bereavement on fund managers' cognitive ability.

While short-term distractions – for example, making funeral arrangements – and limited attention were expected during the initial months around parental death, it was less likely that such distractions persisted in the longer run. Instead, the prolonged fund underperformance was consistent with the long-term negative emotional effects of filial bereavement.

We investigated one such potential distraction – the sale of the deceased parent's real estate properties. Real estate sales can take a long time and potentially cause a long-lasting limited-attention effect.

However, we found that only about 20 per cent of parental death events were followed by the sale of parental real estate properties. Moreover, the majority of these sales were completed shortly after the death event. Only 5 per cent of the death events had property sales completed more than a year after. Together, it was unlikely that this distraction led to the persistent underperformance.

Psychology research suggests that negative moods induce heightened perception of risks and danger. There were indications that filial bereavement may well have reduced the risk-taking propensity of fund managers.

First, the returns of bereaved fund managers exhibited lower tracking errors after parental death, suggesting that bereaved active fund managers became more passive and behaved more like quasi-indexers.

Second, they also went for safer options, shifting some of their holdings in stocks with smaller market capitalisation to larger-cap stocks.

Third, bereaved funds turned over their portfolios less frequently – portfolio turnover rates declined by about 8.33 percentage points during the event window or about 20 per cent of the pre-event turnover rates.

Lastly, we found that bereaved fund managers were more sensitive to poor stock performance that could trigger additional negative mood. They were more likely to eliminate their holdings in stocks that experienced negative returns.

Parental death can also trigger a sense of loss and an urgency to obtain potentially rewarding replacements. We studied fund managers' decision to sell a winner stock from the fund portfolio. We found that after parental death, fund managers were more likely to realise paper gains by selling past winner stocks, especially extreme winners.

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Would performance under bereavement be affected by the age of the fund manager? We expected that when one loses a parent at a younger age, that event may have a stronger impact, especially in the short term, as the death is less anticipated. Indeed so. The negative impact of parental death was substantially stronger for younger managers, with most of the effect concentrated around the event period.

Economics has always been driven by rational considerations. We expected professional money managers to be such rational agents.

But our research showed that personal life experience can influence people, including professional investors' financial decisions and outcomes. Indeed, death left not only a heartache but also less rational decision-making.

• The writer is associate professor of finance at NUS Business School. This research was carried out in collaboration with Associate Professor Tao Shu at University of Georgia and Associate Professor Eric Yeung of Cornell University.

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