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Financial Literacy and Mutual Fund Investments: Who Buys Actively Managed Funds?

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Abstract

Previous research indicates that a lack of financial sophistication might explain the past strong growth in active management. We construct an objective financial literacy score and analyze the relation between financial literacy and mutual fund investment behavior. We show that there is a positive influence of financial literacy on the likelihood of investing in low-cost fund alternatives. However, we find that even the most sophisticated investors in our sample rely overwhelmingly on active funds. “Smart money” among smarter investors cannot explain this finding as there is only weak evidence of superior

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