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Capital and Community: Findings from the American Investment Craze of the 1990s

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Ten Years That Shook the Market

Much that can be said about the economic *Zeitgeist* of 1990s America can be encapsulated in the publication of three books in rapid succession between May and September 1999: *Dow 36,000*; *Dow 40,000*; and *Dow 100,000*. Issued by three different publishers, and written by three different sets of authors, each book vied to be the most optimistic about the upward trajectory of U.S. stocks. Though we might now wish to shelve these books in the science fiction section of the library, at the time their ideas were treated quite seriously and discussed earnestly in public news forums. However implausible it might seem in the morning-after light of the early 21st century, these books simply reflected the remarkable events occurring immediately before and after their publication.

Among the most notable legacies of this extraordinary period was the transformation of the majority of adults in the U.S. into investors. Investing was once the exclusive province of a tiny elite: in 1900, only one percent of Americans owned stocks, and that number barely changed for generations, reaching only four percent by 1952. But investing became a mass activity during the 1990s, so that by the end of the 20th century, an unprecedented 53 percent of Americans held investments in the stock market. Moreover, half of these new investors were women, and many others were people of color – two groups that were scarcely to be found anywhere near Wall Street until the past decade. A report by the United States Congress called it "an explosion in stock ownership."[1] The *New York Times* proclaimed a new era of "shareholder democracy"[2] and *Newsweek* called it "one of the great social movements of the 1990s."[3]

Who were these new investors, and what was the socioeconomic impact of their mass entry into the stock market? Though they were the object of much speculation and hyperbole, the rise of these "retail" investors, as they are known to finance professionals, was so swift that no one really knew. So I conducted a study to find out. My book, *Pop Finance: Investment Clubs and Stock Market Populism* (forthcoming from Princeton University Press), is the first – and, as far as I know, still the only – study to examine this "new investor class." The book is based on two years of multi-method research I conducted, starting with a year of participant observation and followed by a national survey. The initial research was conducted in 1998, near the height of the bull market; following the market's swift decline in a few years later, I returned to the investors I had worked with in my original participant observation study, and interviewed them about how their financial behavior and outlook had changed.

Despite the dramatic changes in the market since 1998, retail investors are still very much an important force in the U.S. stock market, and I believe they will continue to wield significant influence. That is because they are not in the market just to make a quick buck – although that is always a factor – but as a result of institutional imperatives that have transformed the provision of old age insurance from a collective responsibility into a problem that individuals must solve for themselves. As European readers may know, the U.S. government offers very little in the way of a social safety net for citizens, and what little we have is shrinking. This has created a colossal public policy problem: the public sector is withdrawing from what few pension obligations it once had at the very time that a large segment of the population is approaching retirement age.

This collision of demographic and institutional change has catalyzed an urgent need to generate retirement savings: for many people, the stock market seemed the only way to make enough money quickly to avoid the spectre of an impoverished old age. The view that mass investment in the stock market would solve the looming retirement crisis was popularized in the press and by the government itself, which underscored the point in 1997 with a massive cut in the capital gains tax: essentially privileging investment income over earned income from work. As more Americans were swayed by these incentives, more started investing, driving stock prices up, and making the profit opportunities even more attractive to other investors – creating, in essence, the kind of recursive, self-referential system typical of speculative manias.4

Investment Clubs and the New Investor Class

How did this new majority of retail investors gain entrée into the stock market in the first place? It is a non-trivial question, since until the 1990s, there was virtually no way to invest *without* the mediation of a stock broker: professionals who charged hefty commissions on each trade, and who would often simply refuse to provide services to anyone except the wealthy; most brokers regarded small investors (including women) as simply not worth their time. But even with the advent of discount brokerage, including online services like eTrade, there still remained formidable barriers to would-be retail investors: namely, the expense of the stocks themselves, and the complex, arcane language that had to be learned in order to begin investing.

This is how investment clubs – voluntary associations of 10 to 15 people who pool their money to invest in the stock market – came to serve as the main point of entry into the stock market for millions of Americans. The clubs allowed individuals to benefit from economies of scale in both financial and temporal terms: by contributing just $15 to $20 at each monthly meeting, each member could buy stocks with the other club members, something they could never afford as individuals; and during the two-hour meetings, during which members would present stock purchase or sale ideas to the club, everyone got some of the investment education they needed. Thus, by the late 1990s, investment clubs went from being an obscure hobbyist movement imported from Europe a century before into a mass socio-economic phenomenon that involved some 11 percent of U.S. investors – about 20 million people. 5

Despite the market downturn since the dot.com bubble burst in early 2000, these investment clubs and their members still wield significant economic power. The figures for one national investment club association tell the story: their thousands of member clubs (composed of half a million individual members) collectively own $125 billion worth of the U.S. stock market and invest an additional $190 million each month.6 Those figures are comparable in magnitude to the investments of CalPERS – the California Public Employees' Retirement System – which has $143 billion in assets under management and is the world's largest pension fund.7 Moreover, retail investors exert a large influence on the market relative to their numbers: while CalPERS represents over 1.2 million California public employees, there are just a few hundred thousand investment club members in the U.S. Though investment clubs do not act as a single unit, as CalPERS and other pension funds do, there is still a consistent pattern of stock ownership among the clubs. For example, the clubs belonging to one national association alone own $562 million worth of General Electric, $423 million worth of Intel, and $1.3 billion worth of the insurance company AFLAC – about 7 percent of shares outstanding.

Given the historical significance of investment clubs in facilitating the retail investor boom, as well as the economic influence these investors continue to wield through investment clubs, it becomes important for scholars to understand how these economic actors think about the market and how they choose to allocate their money. A major objective of my study was to document the real-world behavior of American investors and to offer an alternative to what might be called the "official" version of stock market dynamics presented by economics and finance, which marginalizes social influences on investor behavior under the rubric of "noise trading."8 Ethnographic research on the practices of investment professionals shows that social influences on investing are not limited to amateurs, but rather pervade the stock market: as one prominent economist put it, "apart from a few lonely Warren Buffetts, institutional investors exist in a community that is exceptionally closely knit by constant communication and mutual exposure."9

Of all the ways to approach this phenomenon, investment clubs provide a particularly appealing starting point, not only because of their economic significance but because they offer the opportunity for detailed observation of the social processes involved in investing. They allow the complex set of practices that is the stock market to be studied on a manageable scale.10 Second, investment club meetings make the decision processes of investors available for analysis. Among individual investors, decision-making can be very difficult to study because so much of the process is internal; little is accessible directly to researchers. In other words, while it is not difficult to find out what investors do, it can be difficult to discover *why*.

In contrast, investment clubs make these processes explicit and available for the researcher. That is because the group process requires members to debate their decisions and take a vote before acting; during the clubs' monthly meetings, members must articulate their reasons for wanting to buy or sell stocks. They have to debate the pros and cons explicitly. Thus, their decisions can be observed unfolding in "real time," rather than being reconstructed retrospectively, with all the potential biases that implies. Observation provides more accurate data through direct access to the process of investment decision-making in groups: a widespread, but under-researched phenomenon about which we need to learn much more.

Methodology

Since there was no prior research on investment clubs, I was unable to embark directly on a large-scale survey project. Instead, I began building knowledge of the groups through observation and interviews. The qualitative phase of the study involved participant observation of seven investment clubs in the San Francisco Bay Area over the course of a year. This portion of the project was guided by two goals: to develop theory and to generate questions for a survey to be mailed to investment clubs nationally. The survey, which gathered both club-level and individual-level information, was intended to create a broader picture of investment club performance, composition and practices, and to serve as a context and benchmark for the qualitative findings.

The sample I selected for participant observation was designed to provide insight into as broad a spectrum of investors as possible while remaining a manageable size for steady, long-term observation. Thus, the sample included clubs of varying gender composition: two all-female, two mixed and three all-male – a category I oversampled because of the small proportion they represent among investment clubs nationally. The sample also varied by age of club: one group was brand new, having formed just a month before I began observations, while another had been in business for more than 40 years. The members themselves were diverse in terms of race/ ethnicity, occupations and age: participants ranged from mid-20s to mid-80s. Finally, I sought variation in performance, including clubs that earned substantial profits on their investments and those that merely limped along, even during a rising market. The average investment club in the U.S. earns a rate of return of approximately 12.6 percent on their portfolios since inception; while this was somewhat above the historical average returns of the U.S. stock market over the past century, it was low for the late 1990s, when rates of return on the market overall often exceeded 30 percent.

Based on what I learned from attending the monthly meetings of these seven groups, I developed a mail survey that went out to 3,000 randomly-selected investment clubs across the U.S. Each club received a packet containing two anonymous survey instruments: one designed to glean group-level information, along with 15 copies of a survey designed to gather data from individual club members. The club presidents filled out a four-page survey consisting of 30 questions about club performance and structure. Individual survey participants also received a four-page survey, which included 31 multiple-choice and Likert-style questions about their demographic background and investing behavior, both within and outside of the club. Usable responses were returned by a total of 1279 clubs, a response rate of 43 percent. The survey also yielded individual level data from over 11,000 members within those clubs; the average rate of individual participation in the study was 70 percent (s.d.=.18).

The survey data painted a portrait of investment club members that closely resembled the averages for the U.S. population as a whole. The average individual survey respondent was between 45 and 50 years old, college educated, earned $52,000 per year (s.d.=$13,000), had 11 years of investing experience (s.d.=6.6), and had belonged to his or her club since its inception. At the group level of analysis, the average club responding to my survey had been in operation for 4.3 years (s.d.=6.4 years), owned a portfolio worth $43,000 (s.d.=$73,000) and had 15 members (s.d.=5). While it was not possible to compare the sample frame for this study with the entire population of investment clubs, analysis of archival data from the non-responding clubs indicated no significant difference in terms of composition, size, age or portfolio value between clubs that did or did not respond to the survey.

Major Findings

Using the theoretical framework I developed in the participant observation part of my study, I developed ideas to test and generalize with the survey data, which I analyzed using standard OLS regression techniques. Below, I have summarized some key findings based on both types of data. Since I can't be as complete as I'd like in this format, I hope that interested readers will contact me with their questions.

Investing as Shopping: the Consumer Orientation to the Stock Market

As part of the social studies of finance literature, my study takes the view that the proper study of markets is how actors assign value to things. Thus, one of the main topics of interest in my research was how investors decide what stocks are *worth* buying, and at what price. Though the questions are rational, the process of answering them is not, in that numerous social forces come into play – particularly social psychological factors like identity and impression management.

The evidence I gathered suggests that people buy stocks in much the same way they buy consumer products like jeans and cars: with an eye not only to the utilitarian properties of the purchase (e.g., something to wear, to drive, or to make money with), but also with consideration for how those purchases speak *for* them: what they say to the world about the kind of person the purchaser is. While it might seem as though a stock is far less observable and available for interpretation by one's peers than an item of clothing or a car, it turns out that investors discuss their portfolios frequently (not to say incessantly) within the social setting of their investment clubs as well as within their neighborhoods, families and workgroups. As a result, one social psychological study found, there is an extremely high correlation in investment choices within neighborhoods: individuals buy virtually the same stocks that their neighbors and coworkers, because they hear about those stocks at barbeques, PTA meetings and around the water cooler.11

In both the qualitative and quantitative portions of my study, I found that American investors seem to have taken to heart the advice of one of the best-known and best-selling investment books in the U.S., which advised would-be investors to "buy what you know."12 It turns out that what people believe they know best is themselves, and they buy stocks that are congruent with their identities (or aspirations) as men, women and moral people. The importance of congruence with notions of self is woven throughout my data on the processes investors use to make decisions among the thousands of stocks available to them.

In fact, I documented repeated instances in which investors rejected stocks because they, as one participant in an all-women's investment club put it, "couldn't identify with" or didn't wish to be associated with some firms. This dis-identification was sometimes based on corporate reputation, as in the case of the club that declined to invest in the building-supply firm Home Depot because of its reputation for discriminating against women employees. But more often, it was a matter of taste, or what Bourdieu would call "distinction," as in the case of the group that refused to buy stock in La-Z-Boy – a manufacturer of reclining chairs and sofas associated with middle-brow American décor – because, despite the firm's excellent economic prospects, it came with class-linked connotations that the investors thought would reflect poorly on them.

The process of impression management was also evident in the tension retail investors experienced around maintaining their social identities as "good people." For instance, a surprisingly large number of clubs chose names like "Investors for Christ," "L'Chaim Investors" or "Episcobucks," suggesting that the age-old conflict between ethics and virtue on the one hand, and money and profit on the other, is still highly salient to contemporary investors. I also saw investors repeatedly reject investments they agreed were likely to be very profitable because they considered the product itself (as opposed to the firm) dangerous and antisocial; for example, one very successful all-women's investment club, after a lengthy and positive financial analysis of Harley-Davidson, decided not to buy the stock because they came to the reluctant conclusion that, at heart, they believed motorcycles were dangerous and antisocial!

The identity issue, and the consumer approach to investing, went far beyond investment club members' attempts to make what they perceived as socially-responsible choices. I found that investors also thought about stocks in a *gendered* way, even going so far as to create a mental model of the stock market that parsed investments into "girl stocks" and "boy stocks" – much the way small children learning their gender roles sort occupations into jobs for girls (e.g., nurse) and jobs for boys (e.g., doctor).

The gender division of the stock market seemed to occur along lines that were first limned in Veblen's *Theory of the Leisure Class* over a century ago: consumption and production. In the qualitative portion of the study, I found that women believed themselves to be most knowledgeable about the consumer products sector of the economy, and thus the bulk of their purchase recommendations to their clubs were for consumer products stocks. Men, in contrast, recommended stocks to their clubs based on their professional expertise: for example, in one all-men's club I studied, the bus driver persuaded the club to buy oil company stocks, the doctor recommended pharmaceutical stocks, and the engineer recommended the stocks of engineering firms. Curiously, though most of the women in my study worked outside their homes, I never saw them use their professional experience as a source of investing ideas, as their male counterparts did. In contrast, I did see men explicitly discuss and reject investment in the consumer products section of the economy, usually based on a vaguely-articulated but evidently shared understanding that it was unseemly for men to invest in that area of the economy!

I was amazed to find these results substantiated by my quantitative data. In analyzing the detailed portfolio records obtained through the national survey, I found that the percentage of stocks investment clubs allocated to consumer products firms was directly proportional to the number of women in the club. Thus, all-men's clubs had the lowest proportion of their assets invested in consumer products stocks, while all-women's clubs held the largest proportion of their funds in consumer products stocks, and mixed clubs were in the middle, allocating investment dollars to consumer products stocks in direct proportion to the percentage of women members.

I dubbed this phenomenon "the logic of gender appropriateness," and argued that it – along with socially responsible investing – were the outcomes of the "new investor class" importing their worldview as consumers into the stock market. They were, literally, *retail investors*. Most importantly, their choices are redefining "shareholder value" with significant implications for the ways that publicly-traded firms operate.

The "Diversity Premium" in Portfolio Performance

This study was catalyzed by a puzzle: according to data collected by a national association of investment clubs, the stock portfolios of clubs composed of men and women together earned significantly higher rates of return than the portfolios of clubs composed of men only or women only. Analyzing all 12 years' worth of portfolio performance data that were available as of 1998, when I embarked on the study, I found that the annual rate of return on investment for mixed groups was higher than that of their single-sex counterparts.

Specifically, mixed groups earned about two percent more on their investments than single-sex groups. While two percent may not sound like much, the process of compounding results in large differences over time. Through compounding, investment clubs earn interest on their interest, as well as on the cash they contribute each month, so that a two percent premium can result in many thousands of dollars in additional profits. It was also surprising to note the absence of any statistically significant difference between the performance of all-male clubs and all-female clubs, suggesting that neither men nor women were better investors, but rather that gender diversity itself made a distinct contribution to group performance.

The findings were unexpected for two reasons. First, economic theory would suggest that the personal characteristics of investors (such as gender) should make no difference in the performance of their stocks. Second, sociological research has repeatedly shown that compositional diversity in task groups causes decreased performance more often than not. Yet the positive effects appeared robust in this data set, and I set out to uncover the origins of the "diversity premium."

Using both the qualitative and quantitative parts of my study, I found that the "diversity premium" had two sources. The first was the different orientations that men and women have to the stock market (sketched in the previous set of findings), which meant that mixed groups had larger and more diverse sources of investing information than single-sex groups. Second, social ties among members of single-sex groups were quite different than those in mixed groups, affecting the quality of their decision processes. Consistent with an extensive literature on group composition, all-men's and all-women's groups were overwhelmingly composed of social friends, while mixed groups were primarily composed of colleagues who knew each other through work and school – the institutions where men and women are most likely to cross paths and form ties. For the sake of their friendships, members of single-sex groups tended to "rubber stamp" each other's investment ideas, inhibiting candid and rigorous analysis of the investing ideas members proposed. In contrast, mixed groups generally developed out of settings like offices and classrooms, in which disagreement was tolerated, or even encouraged. As a result, mixed groups not only had norms of constructive debate, but had less to lose socially from such discussions than their same-sex counterparts; this produced more considered, and more profitable investment decisions. Thus, while few investment clubs got rich – most underperformed the market index (the S&P 500) by about 20 percent, like 75 percent of professional investment managers**13** – groups composed of men and women together consistently earned higher returns on their investments.

Investment Clubs as Micro-Finance for the Developed World

Investment clubs as an organizational form bear a striking resemblance to another mode of economic self-help: micro-finance groups, such as rotating credit associations (ROSCAs). Both investment clubs and ROSCAs are voluntary associations in which members make monthly cash contributions to a collective enterprise designed to build their economic independence. Such organizations have a significant economic impact in developing countries; for instance, a number of micro-finance associations have gone well beyond lending money, extending into investment in commodities such as steel roofing material or even currency equivalents. Some rotating credit associations in Africa are reported to hold assets in excess of U.S. $1 million, and many have developed elaborate governance structures.**14**

To find essentially the same techniques in use by middle-class citizens of one of the world's most economically-developed nations is a startling irony produced by a generation-long unraveling of institutions designed to provide collective economic goods. Like micro-finance organizations in developing countries, investment clubs in the United States address needs that are not met by the state or financial institutions. But while micro-credit associations primarily serve the poor, the techniques of "frontier capitalism" are being used by Americans who are far better off economically, but who have real concerns about sinking into poverty through holes in the social safety net. With 80 percent of members saying that their primary investing objective is to save enough to support themselves after 65, the investment club phenomenon can be read as an indicator of the degree to which stratification by wealth has shredded our social safety net.**15**

Social Capital and Civil Society

As voluntary, communal undertakings involving millions of people, investment clubs are a significant part of the associational life of the United States. They may also counter some of the dangers Putnam warns about in his portrait of declining civic life in America. Civil society thrives by bridging demographic and other boundaries, and investment clubs certainly provide the resources that to Putnam define civic engagement: "trust, norms and networks that can improve the efficiency of society by facilitating coordinated action."**16**

In addition, as Habermas argues in his theory of "communicative action," such voluntary associations help members become "more competent members of modern societies" by teaching them to engage in constructive argumentation. Characteristics of such groups include:

- Decision processes in which conflicts are resolved solely by the "force of the better argument"

- Cooperation in defining and achieving shared goals

- An equal voice in the process for all group members, including the ability to introduce proposals or call others' proposals into question

- The absence of threats to free and equal expression of ideas**17**

The case of investment clubs very closely approximates Habermas' vision of an "ideal speech situation." Learning to be an investor *through the vehicle of investment clubs*, as opposed to outside of a group context, has the secondary consequence of teaching the "communicative ethics" and discursive rules on which Habermas argues civil societies are built. Moreover, investment clubs provide a financial incentive for this behavior: the "diversity premium," which rewards those who engage in the common task across demographic boundaries. In this sense, there is reason for optimism about the flourishing of investment clubs, and their potential to repair some of the damage done to civil society in the U.S. in recent years.

Future Directions

To some, the technological advances that have permitted stock exchanges to operate without human traders, and individuals to trade without brokers, might make face-to-face groups like investment clubs seem like quaint anachronisms, irrelevant both for practice and for scholarly research. However, there are several reasons to think otherwise. In practical terms, the most important financial decisions in the world are made, and will continue to be made, in small group settings. For example, many of the most important decisions affecting the U.S. economy are made in small groups such as the Federal Open Markets Committee – a group of bankers who set interest rates and fiscal policy – as well as the numerous investment committees that decide how to spend the money of America's corporations and non-profits. Investment clubs are worthy of study in their own right, but they are also valuable to investigate as instantiations of an important socio-economic practice which has received very little attention from social scientists.

Indeed, Castells argues for the *increasing* value of face-to-face groups as machine-mediated interactions become more prevalent: "As more information flows through networked connectivity, the more important become the kinds of interactions grounded in a physical locale." In other words, the increasing ability to conduct transactions in the absence of physical contact not only does *not* threaten obsolescence for face-to-face groups like investment clubs but rather *enhances* their socio-economic value – a phenomenon known as "Castells' paradox."**18** Thus, in addition to their empirical significance as part of the economic and cultural history of capitalism in the U.S., investment clubs are poised to grow in both scope and influence for scholars, providing insights on such issues as: how value is socially constructed, who is empowered to participate in this social construction, and how micro-social factors aggregate to the level of macro-social institutions.

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Capital and community: Findings from the American investment craze of the 1990s. January 2007. B. Harrington. Read more. Chapter. The crisis of global capitalism: Toward a new economic culture? January 2011. M. Castells. Read more. Chapter. Risk and Capital Formation: Seigneurial Investment in an Age of Adversity. January 2011. Martin Stephenson.Â You can request the full-text of this chapter directly from the authors on ResearchGate. Request full-text. Already a member? The venture capital industry has prospered most in the US and the vast majority of the academic literature has been concerned with the US. In a cross-country study of venture capital, Jeng and Wells (2000) using data from 1986-1995 for 21 countries document that venture capital. 1 See Freear and Wetzel (1994). 1. is less important in other countries. Their main finding is that the existence of an active IPO market is the most important determinant of the importance of venture capital in a country. This consistent with the finding of Black and Gilson (1998) in a comparison of the US and Germany