

INFORMATION GAPS LIMITING INVESTING

POTENTIAL INVESTORS GENERALLY CAUTIOUS

8 OCTOBER 2015

The disconnect between investment theory and observed market trends in Barbados may be related to four information gaps: limited understanding of features of financial instruments; limited information on all features of financial instruments; lack of trust in financial institutions; and, the inability to comfortably assess risk and return. These gaps could result in dissatisfaction with local investment options, apprehensive and risk-averse attitudes to investing, and a lack of trust in financial institutions, all resulting in an overall low appetite for investing in Barbados.

The question of the level of sophistication of Barbadian investors has preoccupied policymakers and researchers for decades, especially given the relative underperformance of the local stock market compared to its larger Caribbean neighbours and the limited effectiveness of monetary policy (which requires efficient financial markets for optimum impact). When you consider the growth trends in available investment products, it becomes clear that further investigation is required to understand the motivations of investors. For example, investment theory suggests that in times of economic uncertainty, fixed income securities will become more attractive than equities. But in Barbados, trends in fixed income securities are unclear. While holdings of debentures and treasury bills by individuals increased since the early 2000s, holdings of savings bonds were generally flat until 2015¹, and trading of fixed income securities declined as the economic slump continued, only rising in 2015 (see Exhibit 1). Debentures have traditionally been popular with local investors, but treasury bills have only recently become accessible since the average size of treasury bills issues has increased and institutional investors have not taken up the extra. .

Trends in equities have followed theory, but given the limited trading on the local stock market generally², it is difficult to make a strong statement that the decline in equity trading observed in Exhibit 2 was in response to the depressed economic environment. In fact, theoretically, even if the

¹ The uptick in 2015 reflects the Central Bank of Barbados' successful educational campaign aimed at increasing investment in savings bonds

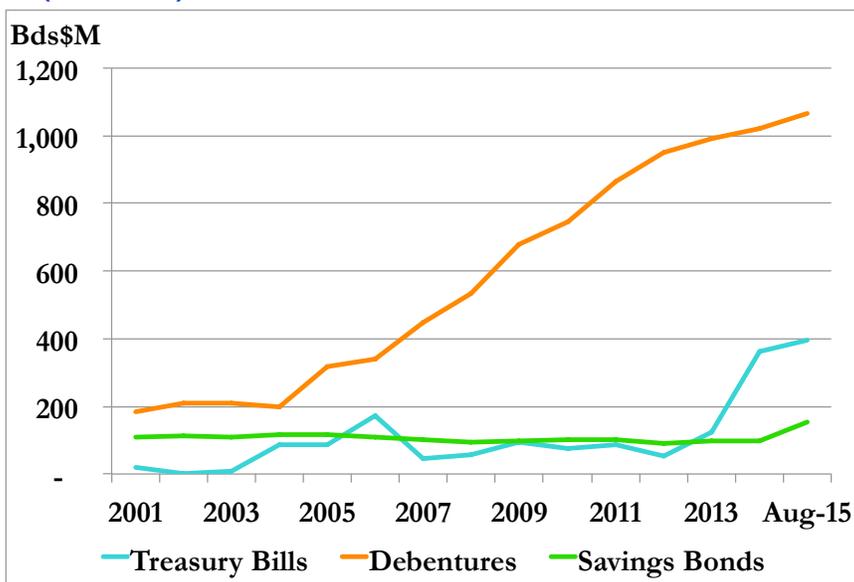
² Of the three biggest stock markets in the English-speaking Caribbean, the Barbados Stock Exchange consistently has the lowest activity.

Exhibit 1

While individual holdings of debentures and treasury bills have increased, holdings of savings bonds (Panel A) and trading of fixed income securities (Panel B) have declined.

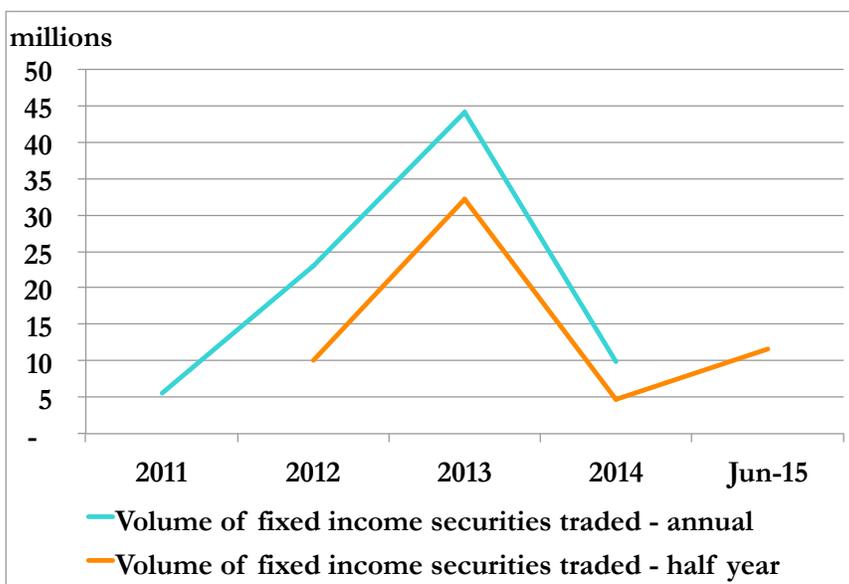
Panel A:

Savings bonds were flat until 2015 when there was an educational campaign to increase investment



Panel B:

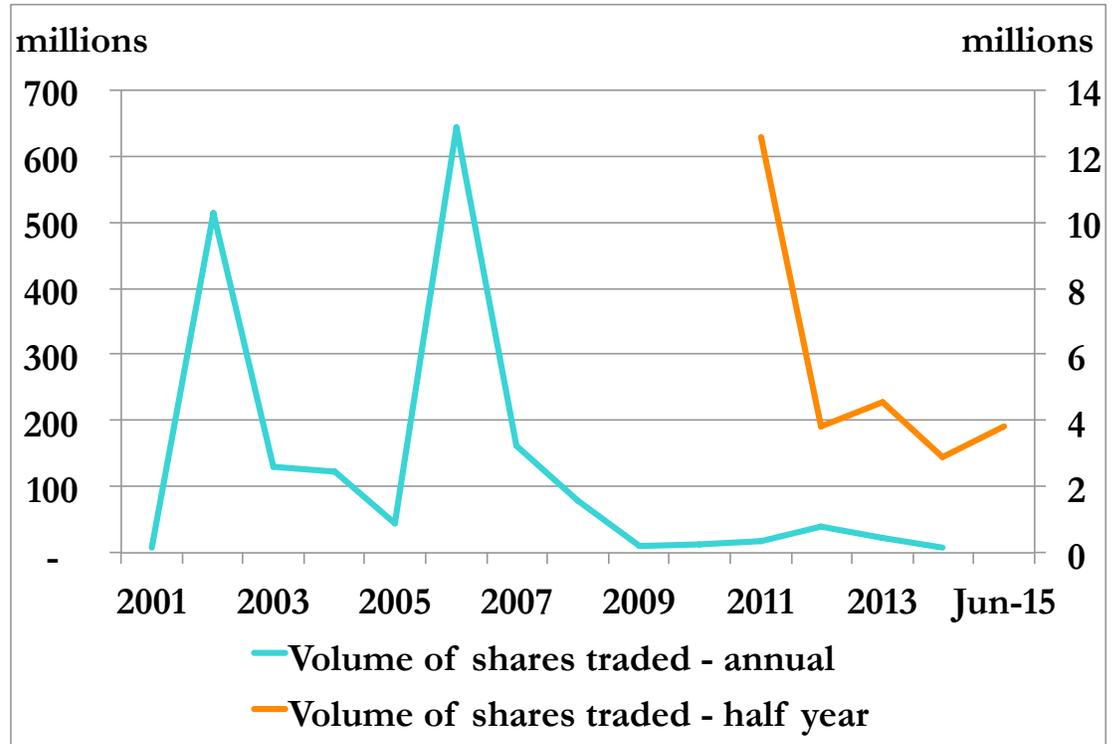
Trading of fixed income



Source: Central Bank of Barbados, Barbados Stock Exchange and Antilles Economics

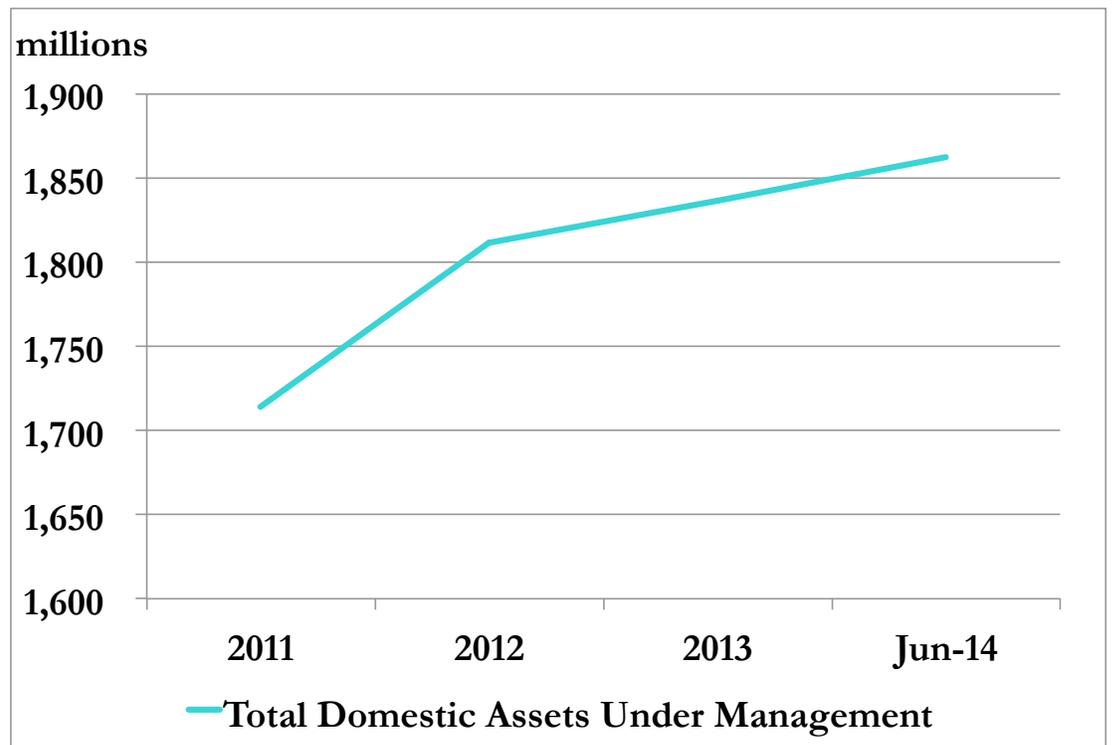
stock market index and market capitalization figures decline, the number of trades need not necessarily also fall. In the Barbados case, both trading activity and the index and market capitalization numbers have fallen, and it is not clear whether this is directly linked to pessimism about the companies listed or dwindling interest in the local stock market. Even the mutual fund market information can be misleading (shown in Exhibit 3), since the existence of fiscal incentives to invest in mutual funds distorts the market, and has resulted in persistent increases in mutual fund holdings, regardless of economic activity. With the removal of the mutual fund incentive, we expect the 2015 numbers to show a slowdown in growth in this market.

Exhibit 2
Trading of equities has dwindled to almost nothing



Source: Barbados Stock Exchange and Antilles Economics

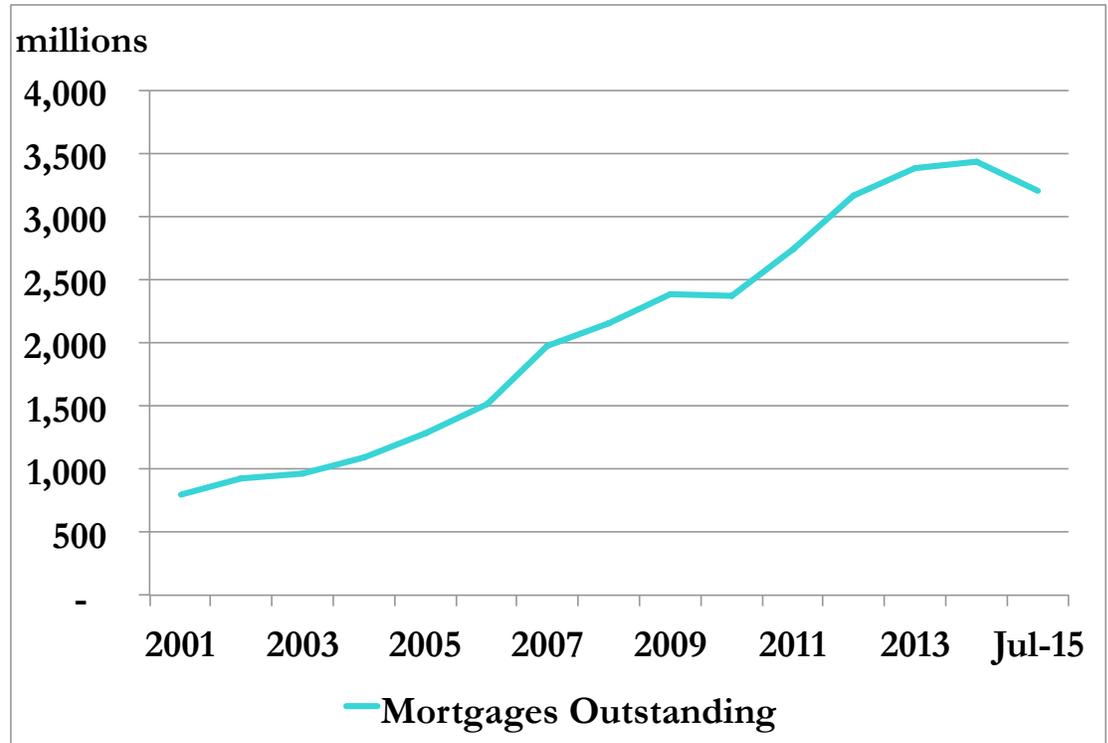
Exhibit 3
Mutual fund market has been distorted by fiscal incentives



Source: Central Bank of Barbados, Financial Services Commission and Antilles Economics

The one market that has consistently performed well in Barbados is the real estate market. But even in this case it is unclear whether the growth in mortgages that has been sustained since the economic downturn began (see Exhibit 4) suggests a vibrant real estate market, persistent housing demand or rising housing prices, since no official data exists on the number of real estate trades. Furthermore, preliminary information up to July 2015 suggests that growth in mortgages may be declining.

Exhibit 4
The housing market has consistently performed well



Source: Central Bank of Barbados and Antilles Economics

Information Gaps May Be To Blame

The disconnect between investment theory and market trends in Barbados may be in part the result of information gaps among investors. In the second half of 2014, Antilles Economics conducted research to investigate attitudes towards saving and investing in Barbados. The research involved focus groups with investors and the general public as well as interviews with commercial bank wealth managers. The feedback from these discussions revealed four information gaps that negatively affect the level of investment in available investment products.

Gap 1: Limited Understanding of the Features of Financial Instruments

The overall desire for investment is reduced when people feel that information on the instrument's features is unclear and confusing. One focus group participant, for example, revealed that since they do not particularly understand the features of a particular product they avoid this type of investment altogether. The bank managers also acknowledged that lack of comprehension is a possible reason for the low investing appetite in Barbados compared to more developed markets. One manager mentioned that while savvy clients exist, the majority of customers have very little understanding of investments' features and benefits.

Gap 2: Limited Information on All Features of Financial Instruments

The details on expected return, brokerage fees and maturity periods are often readily provided to those considering investments; however, other aspects such as government taxes and penalties are not always shared upfront. Understandably, investors who learn of these features only after investing become extremely cautious about making similar investments in the future. Some participants shared experiences where they expected a particular outcome based on a financial advisor's initial advice, but were told they had misunderstood the investment's features only when the time came to receive the benefit. For example, one investor explained if they were aware of the applicable government taxes before investing, they may not have made that commitment or cashed in before the instrument matured. These omissions also impact potential investors who are hesitant to invest because they are not sure they fully understand the investment features. This was highlighted when the facilitator, after clarifying key features of one type of product (tax exemptions, minimum investment amounts etc.), realised that interest in investing increased once participants better understood this instrument.

Gap 3: Lack of Trust in Financial Institutions

Linked to the previous point is the fact that many potential investors simply do not trust financial institutions and their advisors. There is a belief that these institutions/individuals are only trying to sell their products/services, are 'greedy' and are not genuinely looking out for the investors' best interests. The unforgettable failure of CLICO in 2009 impacted thousands of policyholders in Barbados, most of who are still awaiting full reimbursement. Furthermore, the fact that many CLICO pensioners

recently stopped receiving their pension, despite the assurances of the Government of Barbados to continue to meet this obligation, has further reduced trust in financial institutions. Although there has been some negative spillover on the Government, the general perception of the public is more positive when compared to their opinions of financial institutions, because the Government has always met its obligations on government securities.

Gap 4: Inability to Comfortably Assess Risk and Return

The expected return and risk involved are two major features impacting investment decisions, yet several persons do not fully comprehend the relationship between the two. The facilitator noticed that while participants grasped these attributes separately, the Risk-Return trade-off was generally not understood by most people, though this improved with education levels and work experience. The inability to comprehend this relationship leads to persons feeling uncomfortable about investments over which they have little control, even though these instruments can provide higher returns than the preferred 'safer' instruments, such as fixed deposits and credit union shares. It also results in persons demanding a higher interest rate on fixed income securities than investment theory would support. Many participants lamented that their safer securities, such as fixed deposits and bonds, should attract interest rates more in line with what would be expected for more risky investments such as equities, though they admitted that they are too risk averse to consider investing directly in a company.

Implications for Sellers of Financial Instruments

The likely consequences of these deficiencies are dissatisfaction with local investment options, apprehensive and risk-averse attitudes to investing, and a lack of trust in financial institutions, all resulting in an overall low appetite for investing in Barbados. Several focus group participants, especially younger ones, prefer a wider selection of investment choices similar to what is available in more developed markets, and those who are satisfied with the local options tend to be risk averse, preferring securities that provide control and guaranteed returns (such as life insurance and savings bonds). We observed that, regardless of income, the most popular typical investment range is under \$1,000, and only a small percentage possess investments over \$25,000.

In this slow growth economy, many Barbadians are simply not interested in investing due to concerns about their job security as well as the

stability of financial institutions. When Barbadians do choose to invest, they prefer the advice of family and friends over that of qualified advisors, although their loved ones may not possess all the necessary information.

What Next

Despite the seemingly depressed appetite for local investments, our research indicates that several Barbadians still seek and respond to attractive opportunities. Financial organisations therefore have the potential to attract investors by improving their investment offerings’ appeal. A primary step would be to repair existing information gaps. The Central Bank of Barbados, for example, realized the benefits of improved information sharing and simpler administrative procedures with the tremendous response to and rapid sales of the savings bonds issued in 2015. Financial institutions should ensure their investment information is easy to understand and comprehensive and that their staff members are capable of clearly communicating the key product benefits and features. An effective and considerate administration process that reduces customer frustration also helps to improve customers’ attitudes and loyalty. A more vibrant and appealing local investment market is possible if greater efforts are made to eliminate investment information deficiencies. With financial organisations focused on providing better information and building confidence, more Barbadians will be open to investing larger amounts, diversifying their portfolio and trusting advice from qualified financial advisors.

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