

Overconfidence in financial planners

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Abstract

Possessing limited knowledge can sometimes cause overconfidence in one's judgment and ability. This limited knowledge creates a "dual burden" because not knowing what we do not know robs us of the ability to recognize it. This research examines the dual burden phenomena by comparing two groups of financial professionals, one group that has earned one certification with another group that has earned the first certification plus a second certification that requires greater depth of knowledge in a specific area, implying greater skill. We find that financial professionals in the less skilled group are actually more confident in their investment and portfolio management skills than those in the more skilled group. © 2011 Academy of Financial Services. All rights reserved.

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1. Introduction

An age-old paradox is that the person who has been exposed less to the world seems to know with greater certainty how the world operates. Studies support this phenomena revealing that ignorance can be blissful, providing a person with overconfidence in his or her judgment and ability. Researchers (Kruger and Dunning, 1999) identified this incongruity and point out that the combination of limited knowledge and overconfidence creates a "dual burden." People do not know what they do not know because "their incompetence robs them

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of the ability to realize it” (p. 1132). Educators likewise have observed and investigated (Nowell and Alston, 2007; Kennedy, Lawton, and Plumlee, 2002) this paradox among students.

Poorer students consistently overestimate their performance while better students underestimate their performance. Knowledge limitations that cause students to perform poorly on exams also keep them ignorant of their abilities. Similarly, practitioners (Nofsinger, 2005) and consumer behaviorists (Alba and Hutchinson, 2000) warn that overconfidence causes misinterpretation of given information as well as the overconfidence in analyzing it. Finally, there is an old saw that no one thinks he knows as much about law as does a first year law student. In summary, individuals with restricted knowledge often possess overconfidence in their ability because they do not have the calibration skills necessary to judge their capabilities.

This research examines how this dual burden phenomenon plays out in the financial services field. Does overconfidence appear among financial professionals? Are the most skilled the least confident and the least skilled the most confident in their abilities? We examine the dual burden phenomenon by looking at two groups of financial professionals. The research compares a group that has earned one certification in a relatively broad area with a group that has earned the first certification plus a second certification in an area that is a subset of the first, presumably making the second group more skilled. The question that this research attempts to address is this: Does the less skilled group have more confidence than the more skilled group?

To address these questions, this article provides background information about these two financial designations. First, we outline the theory on which the article is based, and then we develop a hypothesis based on the emphasis, focus, and requirements of these designations. Next we discuss the research methodology used to gather data from two groups of financial professionals with the specified professional designations. We then report on the surveys’ results and indicate whether the hypothesis is supported or not. Finally, we discuss the results and managerial implications of the study and outline the study’s limitations.

2. Background

In the United States, millions of aging baby-boomers find themselves with money to invest, ever-increasing questions about retirement planning, and employers progressively shifting more investment decision-making to them. Moreover, almost nine out of 10 people will seek professional financial advice once their investable assets top \$100,000 (McLean, 1998), and experts predict that over \$10 trillion will pass from one generation to the next by 2040 (Hart, 2000). As incomes climb, people increasingly seek the services of financial investment advisors. There are numerous certifications and designations that financial service providers can earn to validate their skill levels. This research uses two such certifications, not to understand the skill levels of each group, but rather to test the theory of the dual burden in a professional services setting. The two designations used in this study are Certified Financial Planner® (CFP®) and Chartered Financial Analyst (CFA).

2.1. CFP and CFA

The CFA charter and the CFP certification are internationally recognized designations that require specified programs of study for financial professionals. Both designations have grown significantly over the last decade. The individual who earns the CFA is a charter holder, and the individual who earns the CFP designation is a certificant. Technically a person is not a CFA or CFP, but rather has earned the CFA designation or CFP certification. For simplicity we often refer to both marks as “designations” and we sometimes refer to persons as a CFA or CFP. While technically not correct, our usage makes the text less cumbersome to read.

The CFA designation and CFP certification are voluntary designations that are not required by regulation to perform the general duties of each profession.¹ An individual can earn either designation or both. The respective issuers of the designations (the CFA Institute and the CFP Board of Standards) are separate entities, and there is no preferred or recommended career path in acquiring them together or separately. Neither designation gives the individual any kind of authority to advise or not to advise. The provision of investment advice for compensation as part of a regular business of providing investment advice, however, is regulated by the SEC or state securities departments and requires licensing. The sale of financial products is regulated and requires licensing.

Required education to sit for the CFP certification examination includes the major topic areas necessary for a comprehensive approach to financial planning for individuals, including investments, insurance, retirement planning, employee benefits, taxation, and estate planning. In contrast, the CFA body of knowledge is grounded more narrowly in the investments area, focusing on security analysis and portfolio management and the tools necessary for those activities.

The qualifications of each designation do not determine the areas in which the individual can work. Additionally, the customer base of the two designations tends to intersect in the area of wealth management, where the two designations are complementary. The CFP designation provides credibility to the CFA in the areas of estate planning and insurance, while the CFA provides credibility to the CFP in the area of portfolio management. Table 1 provides a summary of the differences in prerequisites, educational requirements, course of study focus, and examination. Both the CFA and CFP designations require certain levels of education, testing, and work experience to achieve the designations. The designations basically certify that the individual has met a certain level of education and experience in the subject matter,^{2,3} has passed the requisite exam(s), and has agreed to abide by a set of ethical standards.

2.2. Theory

If confidence reflects what we think we know, and accuracy reflects what we know, then overconfidence is then that upward gap between what we know and what we think we know. Psychologists hold that overconfidence causes people to overestimate their knowledge, underestimate risks, and inflate their ability to control events. Research shows that people routinely overestimate themselves relative to other individuals. For example, they perceive

Table 1 Prerequisites, experience, and body of knowledge

	CFP	CFA
College graduation requirement	Yes	Yes
Work experience	Three years minimum	Four years minimum
Examination	Ten hour, two-day exam	Three exams taken over 2.5 years
Body of knowledge and course of study focus	<p>Focuses on major areas of financial planning necessary for a comprehensive approach to individuals</p> <p>Economic concepts Time value of money Code of ethics and standards of professional conduct Investment and portfolio management</p> <p>General portfolio management knowledge Estate planning, insurance planning, personal risk management, personal income tax planning, retirement planning, college planning, and employee benefits</p>	<p>Focuses on investments and the tools necessary for analysis</p> <p>Economic concepts Time value of money Code of ethics and standards of professional conduct Investment and portfolio management</p> <p>Extensive portfolio management knowledge International asset pricing models, foreign currency issues, and international portfolio management</p>

themselves fairer, luckier, more virtuous, and better investors than others (Dunning, 2005; Dunning, Heath, and Suls, 2004; Epley and Dunning, 2000; Messick, Bloom, Boldizar, and Samuelson, 1985; Moore, Kurtzberg, Fox, and Bazerman, 1999; Weinstein, 1980)

Kruger and Dunning (1999) conducted a series of empirical studies that investigated overconfidence and the dual burden that accompanies it; “the incompetent are less able than their more skilled peers to gauge their own level of competence” (p. 1122). This inability to understand one’s own limitations leads to overconfidence. Kruger and Dunning found that participants in the bottom quartile of ability thought themselves above average while those in the top quartile underestimated their ability relative to their peers. Moreover, their research showed that incompetent individuals were less able to recognize competence when they saw it.

While Kruger and Dunning’s work dealt with areas such as humor and logical reasoning, other researchers have investigated overconfidence in investing and financial services (Nofsinger, 2005; Baker and Nofsinger, 2002). In an investment situation, overconfidence causes individuals to misinterpret the accuracy of information and overestimate their skill in analyzing it (Barber and Odean, 1999). Researchers have found “extreme overconfidence with tasks of great difficulty such as the prediction of stock price changes” (Van de Venter and Michayluk, 2008, p. 547). Another finding was that individuals show more overconfidence as prediction levels increase (Dittrich, Guth, and Maciejovsky, 2005; Brenner, Koehler, Liberman, and Tversky 1996). Other studies have shown that certain demographic groups display more overconfidence in their ability to manage investments (Bhandari and Deaves, 2006). More recently researchers have begun investigating individuals who advise clients on financial services, and they have found overconfidence in the financial market

predictions of a sample of Australian financial planners (Van de Venter and Michayluk, 2008). The overconfidence manifested itself not only in biased predictions but also in a range of predictions that was much too narrow.⁴

Although this latter body of knowledge shows that overconfidence exists in the financial services domain and can lead to less than optimal results (Deaves, Luders, and Luo, 2005; Barber and Odean, 2000), no research has investigated the “dual” part of the Kruger and Dunning’s burden, that is, the less skilled are less likely to know they are less skilled. This research tests their findings in a professional services setting. It investigates whether those with less training in financial service areas will be more overconfident and those with more training will be less confident.

We concentrate on the investments aspect of both designations. As noted earlier, the CFP certification exam covers several major categories in financial planning (insurance, employee benefits, retirement planning, tax, estate planning, and investments), but the CFA exam covers only investments. Approximately 20% of the questions on the 10-hour CFP exam cover investment topics, but there is no requirement to answer successfully any particular percentage of the investment questions. Indeed, it is theoretically possible, though highly unlikely, to pass the exam despite answering all the investments questions incorrectly. In contrast, except for the ethics topics nearly 100% of the 18 hours of the three CFA exams cover investment topics. Further, within the investments area, the CFA educational materials have greater depth and breadth than the CFP requires. Although CFP certificants receive significant training in investments, the designation is more generalist and more oriented toward the personal financial planning aspects of investments.

It is clear that the CFA requires greater knowledge of investments and is widely accepted as the preeminent designation in the investments field. Our implicit assumption, then, is that a CFA charter holder who has also earned the CFP certification has greater knowledge of investments than a CFP certificant who does not have a CFA charter.⁵⁶

2.3. *The study*

Based on the previous discussion, we hypothesize that the more skilled group, holding both the CFP certificate and the CFA charter, will be less confident in their investments-related skills than the less skilled group, holding only the CFP certificate. To test this hypothesis, we first sent a questionnaire to all 882 individuals who held both the CFP certificate and CFA charter at that time; 306 respondents returned the surveys, 265 surveys were usable, representing a 30% usable response rate. Seventy-five percentage of the sample resided in the United States, while the other 25% resided outside the United States.

A second survey was conducted approximately one year later and contained a subset of the same questions contained in the first survey. An invitation to participate in the second survey was emailed by the CFP Board to its full list of members with email addresses. We received 201 usable responses to the second survey.

A profile of the studies’ samples showing the professional demographics of the individuals who responded to the survey is contained in Table 2. Because the CFP-only survey included investment questions and to shorten the length of the survey, many of the demographics questions were excluded. Hence, Table 2 contains many N/A responses for the ‘CFP Only’

Table 2 Sample profile percentages of survey respondents for each category of and education characteristic

	CFP and CFA (<i>n</i> = 265)	CFP only (<i>n</i> = 201)
Client type		
Exclusively or primarily private	65%	N/A
Exclusively or primarily institutional	13%	N/A
Even mix	10%	N/A
Other	12%	N/A
Client size (median client account size)		
\$1,000,000 or more	39%	N/A
\$500,000–\$999,999	20%	N/A
Less than \$500,000	21%	N/A
Not applicable	19%	N/A
Job title		
Financial or investment advisor	29%	N/A
Portfolio or fund manager	18%	N/A
Investment consultant	9%	N/A
Financial planner	8%	N/A
CEO/principal	9%	N/A
Broker/registered rep	5%	N/A
Other	23%	N/A
Firm size		
Small: 1–10 employees	34%	46%
Medium: 11–1,000 employees	35%	20%
Large: Over 1,000	31%	34%
Education		
High school or some college	1%	11%
Bachelors or some post-bachelors	40%	54%
Masters	43%	32%
Other graduate	17%	3%
Major		
Accounting	12%	N/A
Business	16%	N/A
Economics	13%	N/A
Finance	40%	N/A
Other	20%	N/A
Country		
USA	100%	75%
Other	0%	25%

N/A = not available for second survey.

column. It is interesting to note that those holding both the CFA and CFP marks tended to concentrate in the private client area. This clientele is likely high net-worth individuals for whom wealth management requires the complementary skills provided by both designations. However, it is worthwhile to note that many CFA/CFP designees do not work with individual clients. Similarly, some of those holding only the CFP certificate do not either, sometimes working for wholesale or retail financial services firms, for example.

The questionnaire covered a range a questions, including the respondents' motivations for earning each designation, what benefits they hoped to receive from the designation(s), their perceptions of similarities and differences between the two programs of study, several professional demographic questions, and a series of 19 questions regarding the skills and

Table 3 Skill preparation *t*-test results for differences in mean responses related to how well the CFP program was perceived to prepare the individual for different financial skills

How well did the CFP Certification Program prepare you to . . . ?*	Mean responses for designations held		Difference	<i>t</i> -statistic
	CFP-only	CFP and CFA		
Sample size	201	265		
Provide overall financial advisory services to				
Individuals and families	2.99	2.87	0.12	1.80
Small businesses	2.25	2.03	0.22	3.36†
Corporations	1.81	1.59	0.22	3.62†
Non-profit entities	1.71	1.58	0.13	2.13†
Provide advice on				
Insurance planning	2.84	2.54	0.30	4.59†
Tax planning	2.75	2.47	0.28	4.26†
Retirement planning	3.14	2.89	0.25	3.95†
Estate planning	2.98	2.69	0.29	4.39†
Provide investment advice and services to				
Individuals and families	2.95	2.51	0.44	5.90†
Small business owners	2.49	2.03	0.46	6.54†
Corporations	1.93	1.58	0.25	5.38†
Non-profit entities	1.82	1.63	0.19	2.93†
Make better judgments on ethical and professional conduct issues	2.97	2.38	0.59	7.08†
Analyze corporate financial statements	1.80	1.35	0.45	7.39†
Analyze individual securities	2.12	1.41	0.71	10.58†
Forecast investment markets	1.76	1.37	0.39	6.12†
Manage investment portfolios for private individuals and families	2.58	1.97	0.61	8.17†
Develop investment strategies and manage investment portfolios for institutional investors	1.85	1.49	0.36	5.20†
Provide services internationally or make professional decisions in a global context	1.70	1.40	0.30	4.49†

*Mean calculated: 1 = not at all, 2 = somewhat, 3 = very well, 4 = extremely well.

†Significant at 0.01 level.

knowledge set that each designation provided them. In particular, respondents were asked “How well did the CFP Certification Program prepare you for each of the following ...” The respondents answered with “not at all” (one point), “somewhat” (two points), “very well” (three points), or “extremely well” (four points), and the means for the respective questions were calculated. Hence, the higher the number, the better the program was perceived to prepare the individual. The CFP-only holder and CFP + CFA holder responses were then compared using a paired sample *t*-test.

3. Results

The results in Table 3 are striking. There is an interesting difference in the overall perception between those holding only the CFP and those holding both the CFP and CFA.

Those holding only the CFP Certification uniformly give the CFP Certification Program a higher rating than those holding both the CFP and CFA designations in their perception of the CFP program's ability to prepare them for the various specified financial tasks. While the perceived relative strengths of the CFP program were consistent (e.g., overall financial advice to individuals and families, retirement planning and estate planning), the means were higher on every question for those holding only the CFP Certification. Except for the first question, each of these differences was significant at the 0.01 level.

The second interesting difference relates to the respondents' perceptions about how well the CFP prepares them to engage in investment related activities. The most significant differences between those holding only the CFP certification and those holding both the CFP and CFA designations were in the areas of security analysis, portfolio management and financial statement analysis. These are the areas of focus for the CFA designation (see Table 1). The results suggest that those who had achieved both the CFA and CFP (i.e., the more skilled) recognized what they did not know by virtue of having obtained only the CFP designation, while the CFP-only group does not know what it does not know.⁷

One other interesting difference between the two groups involves the question about preparing the respondent to "make better judgments on ethical and professional conduct issues." Here again the CFP-only group felt significantly more prepared from the CFP educational program than those holding both the CFP and CFA. As Table 1 indicates, both designations contain ethics and code of professional conduct content, but the treatment is more in depth in the CFA program.

3.1. Alternative explanations

The results indicate that those holding only the CFP certification give that program a higher rating in their perception of its ability to prepare them for certain specified financial tasks than the rating assigned by those individuals possessing both certifications. It is possible that those who obtained the CFA first are unlikely to feel that the CFP certification prepared them for investments because they already knew about investments, that is, they are saying that the CFP did not prepare *them*, but they are not necessarily saying that it would not prepare a non-CFA.

To examine this possibility, the survey of those holding both CFP and CFA designations was split into two subsamples, those who had obtained the CFP first and those who had obtained the CFA first (see also footnotes 2 and 7 above). The mean responses of these two subsamples were then compared. There was not a statistically significant difference in the perceptions of these two subsamples with respect to any of the questions contained in Table 3,⁸ indicating that the order in which the designations were earned was not a factor.

4. Conclusions

More limited knowledge about a subject matter can provide an individual with overconfidence and create a dual burden because the more limited knowledge indicates that the "individual doesn't know what he doesn't know." This research examines the dual burden

phenomenon by comparing two groups of financial professionals. It compares a group that has earned only the CFP certification with a group that has earned both the CFP certification and the CFA charter, designating the second group as more skilled. We find that financial professionals in the less skilled group are significantly more confident in their perception of how well the CFP program prepared them to perform various financial services. Such differences in perception are more significant for investment and portfolio management tasks.

We should point out that we are using a unique data set in which one set of people has a single designation and the other set has the first designation plus another. Our assumption is that the set holding only one designation has more limited knowledge than the set holding both designations. We are then interested in how the *perceptions* of the set with more limited knowledge differ from the perceptions of the “more knowledgeable” set. Our analysis does not test actual skill differences between the two sets, but rather examines these individuals’ perceptions about how well prepared they felt by virtue of the designation(s) they possessed.

From an economic standpoint, the real issue would be the extent to which these differences in perception lead to differences in behavior. That is, does the set of individuals possessing only one designation provide investment planning advice that is not commensurate with their skill set? We have no way of assessing this issue. In addition, our results imply nothing about the CFP program, or CFA program, per se. These programs have different objectives and different focus, which we take as given.

4.1. A final thought

A take-away for the CFP practitioner is the idea that, as a group, CFP practitioners may be overconfident in their skills in the investments area. At the very least, when evaluating investments they should ask themselves if their own confidence level is properly matched to their actual skill level. After all, it is not reasonable for the typical CFP certificant to have more confidence in his or her preparation in investments than the typical CFP certificant who has also earned the CFA charter.

Notes

1. In addition, the Chartered Financial Consultant (ChFC) and Chartered Life Underwriter (CLU) are voluntary designations awarded by The American College based on the completion of eight distance learning courses each.
2. For those persons in the sample who hold both the CFA and CFP designations, 200 acquired the CFP designation first, while 44 acquired the CFA first, and the remaining approximately 20 listed the same year for each or did not answer completely.
3. For an analysis of factors that are associated with success on the CFP examination, see Cutler et al. (2005).
4. In a related study of the behavioral characteristics of financial advisors, Nofsinger and Varma (2007) find that financial planners are more analytical, as opposed to intuitive, decision makers than the general population.

5. The literature on overconfidence uses terms such as ‘less skilled,’ ‘incompetent,’ and ‘limited knowledge,’ among others. We want to be clear that we are not suggesting that CFPs are any of these, but rather that, relative to a CFA, a CFP is likely to have less knowledge of investments. Note that both CFP Board and the CFA Institute use the term “minimally competent” to describe the individual who barely clears the hurdle on the exam.
6. We do not have a dataset with statistics for those persons holding a CFA designation only. Consequently, we are unable to compare CFAs only with CFA/CFPs for the questions pertaining to investment skills. We are thus also unable to test whether CFAs only are overconfident vis a vis CFA/CFPs with respect to certain skills likely to be more in the domain of the CFP.
7. The survey of those holding both CFP and CFA designations was split into two sub-samples, those who had obtained the CFP first and those who had obtained the CFA first (see also footnote 2 above). There was not a statistically significant difference in the perceptions of these two sub-samples with respect to any of the questions contained in Table 3.
8. It is also possible that those who completed the CFP first and the CFA last weigh the more recent program more heavily, consistent with evidence that individuals overweight more recent events. Consequently, this sub-sample could also give the CFP a relatively lower rating. If this is the case, both sub-samples would be rating the CFP relatively lower, though for different reasons.

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