

# The Effects of Financial Literacy, Income, and Risk Preference on Investment Decisions: The Mediating Role of Return Perception

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## Abstract

*This study explores the influence of financial literacy, income, and risk preference on investment decisions, with return perception as a mediating variable among millennial investors in Yogyakarta. A quantitative approach was applied, using questionnaires distributed to 110 respondents who had engaged in investment activities at least once. Data analysis was conducted with SmartPLS 4.0 to examine both direct and indirect effects. The findings indicate that financial literacy and risk preference significantly and positively affect investment decisions, while income shows no direct effect. Return perception has a significant positive impact on investment decisions and mediates the relationship between income and risk preference with investment decisions, but does not mediate the effect of financial literacy. These results highlight the importance of psychological and economic factors in shaping millennial investment behavior. Return perception emerges as a key mechanism that bridges rational aspects, such as income, and behavioral aspects, such as risk preference, in determining investment choices. The study provides implications for policymakers and financial institutions to strengthen literacy programs and design strategies tailored to millennial investors.*

**Keywords:** financial literacy, income, investment decision, return perception, risk preference.

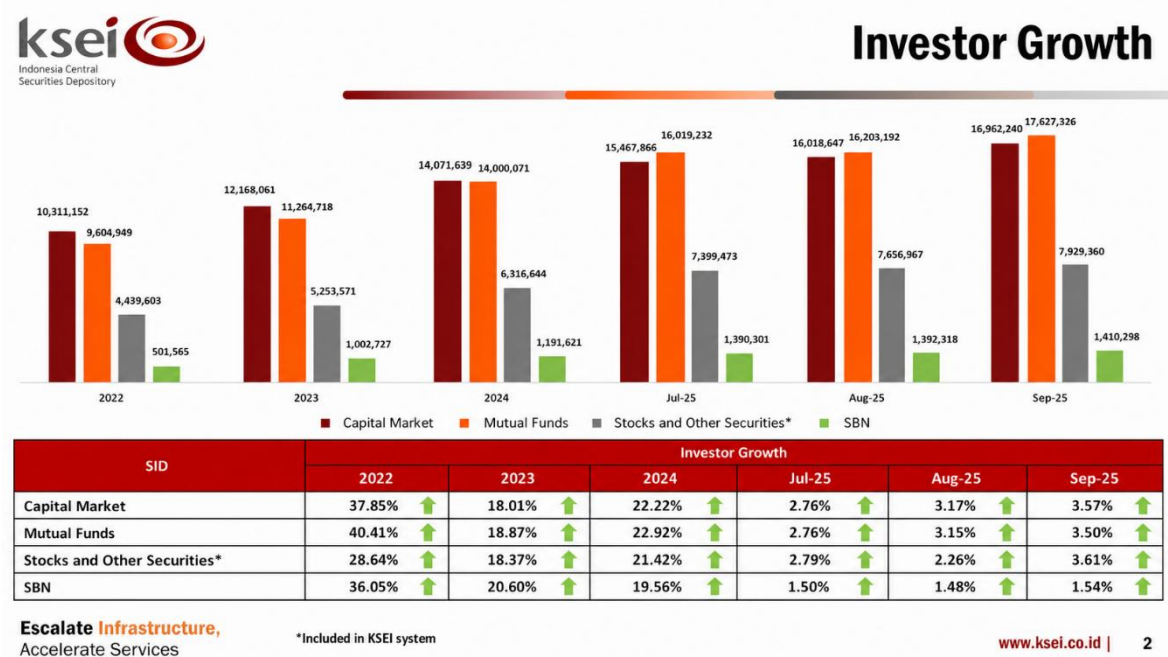
## Introduction

Investment activities among individuals have grown rapidly in the era of globalization and financial digitalization. In Indonesia, data from the Indonesia Central Securities Depository recorded 18.6 million registered investors, with millennials accounting for 54.20% or approximately 10.1 million (KSEI, 2025). However, compared to the total millennial population of 73.6 million, the proportion of active investors remains relatively low at 13.7% (World Economic Forum, 2025).

Despite increasing access to diverse investment instruments, millennials in Yogyakarta still tend to prefer low-to-medium risk assets such as gold, mutual funds, and deposits (GoodStats, 2022). Participation in higher-risk instruments like stocks and bonds remains limited, reflecting the influence of risk preference, income stability, and financial literacy in shaping investment decisions (Hariputra & Rita, 2023).

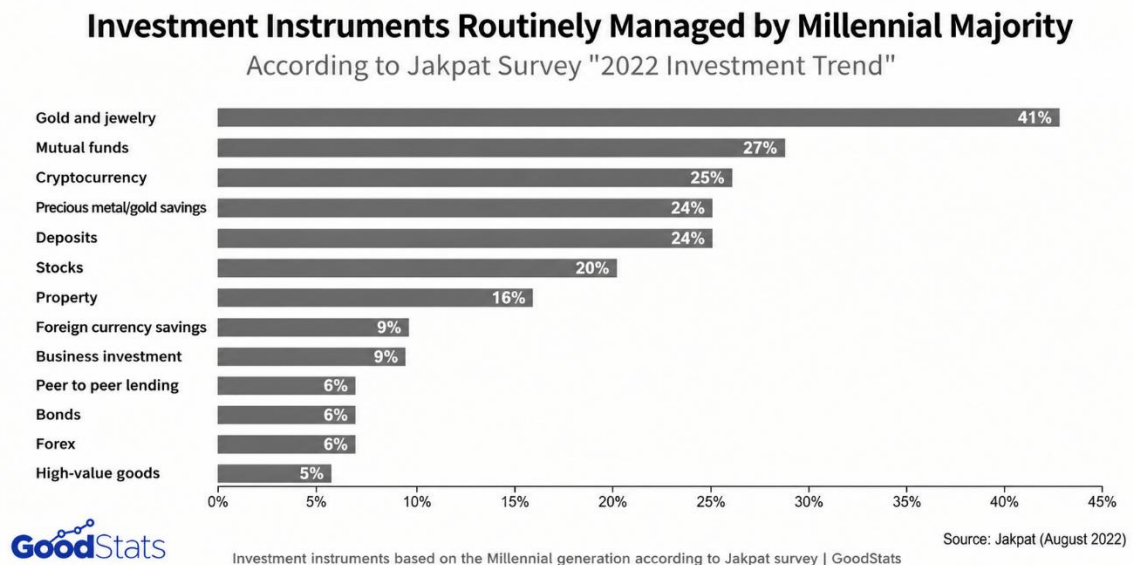
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**Figure 1. Growth of Capital Market Investors in Indonesia (July–Sept 2025)**

Source: Indonesian Central Securities Depository (KSEI, 2025)



**Figure 2. Investment Instruments Regularly Managed by Millennials**

Source: GoodStats (2022)

Financial literacy plays a fundamental role in enabling individuals to evaluate risk-return trade-offs and make rational investment choices (Sunarko & Sutrisno, 2025). Government initiatives, such as the National Strategy for Financial Literacy, emphasize the importance of improving literacy levels to enhance financial

independence and participation in capital markets (OJK, 2021). However, empirical evidence suggests that literacy alone does not guarantee active investment behavior (SNLIK, 2025).

Income also serves as an important determinant of investment capacity. Higher income levels provide greater financial flexibility and confidence to allocate funds into investment instruments (Wardani & Widajatun, 2025). Yet, income effects are often intertwined with psychological factors, particularly return perception, which influences how individuals evaluate potential gains relative to risks (Sulistyowati et al., 2022).

Risk preference further shapes investment behavior, as millennials often exhibit risk-averse tendencies, favoring safer instruments despite access to digital platforms offering higher-yield opportunities (Sunarko & Sutrisno, 2025). This highlights the importance of understanding how risk attitudes interact with perceptions of return in determining actual investment decisions (Sulistyowati et al., 2022).

Return perception functions as a psychological mechanism that bridges rational and behavioral aspects of decision-making. It mediates the relationship between financial literacy, income, and risk preference with investment decisions, reflecting how expectations of returns influence investor confidence and choices (Syawaluddin & Ispriyahadi, 2023). Similar findings also emphasize that return perception strengthens the link between risk preference and investment behavior (Putry & Kesau, 2023).

Previous studies have produced mixed findings regarding the role of financial literacy, income, and risk preference in investment behavior. Some highlight direct effects, while others emphasize the mediating role of psychological factors (Kristianti & Kristiana, 2023).

Limited attention has been given to return perception as a mediating variable, creating an empirical gap. This research seeks to address that gap by analyzing the influence of financial literacy, income, and risk preference on investment decisions through return perception among millennial investors in Yogyakarta (Sunarko & Sutrisno, 2025).

## **Literature Review**

### ***Prospect Theory***

Prospect Theory explains that individuals in making investment decisions are not solely guided by rational calculations but are also influenced by risk perception and potential gains (Kahneman & Tversky, 1979). This theory is relevant to millennials who often display risk-averse tendencies despite having broad access to digital investment instruments (Sunarko & Sutrisno, 2025).

### ***Financial Literacy***

Financial literacy refers to the ability of individuals to understand financial concepts, manage assets, and evaluate investment risks and returns (Sunarko & Sutrisno, 2025). Higher levels of financial literacy enhance financial confidence and the ability to assess return expectations (Syawaluddin & Ispriyahadi, 2023). However, some studies argue that financial literacy does not always directly influence investment decisions but rather operates through return perception (Putry & Kesau, 2023).

## ***Income***

Income functions as an economic factor that determines the actual capacity of individuals to invest (Wardani & Widajatun, 2025). Individuals with higher income tend to be more willing to take risks because they possess sufficient financial buffers (Sulistiyowati et al., 2022). Moreover, income influences perceptions of return, as higher income levels make individuals more realistic in evaluating potential gains (Wardani & Widajatun, 2025).

## ***Risk Preference***

Risk preference reflects an individual's attitude toward investment uncertainty. Millennials in Yogyakarta still demonstrate risk-averse behavior, preferring low-yield instruments such as savings or deposits (Sunarko & Sutrisno, 2025). Conversely, investors with higher income are more capable of accepting risks in pursuit of greater returns (Sulistiyowati et al., 2022).

## ***Return Perception***

Return perception acts as a psychological mechanism that mediates the influence of financial literacy, income, and risk preference on investment decisions (Syawaluddin & Ispriyahadi, 2023). A realistic perception of returns encourages rational investment decisions, while unrealistic perceptions often hinder participation (Putry & Kesau, 2023).

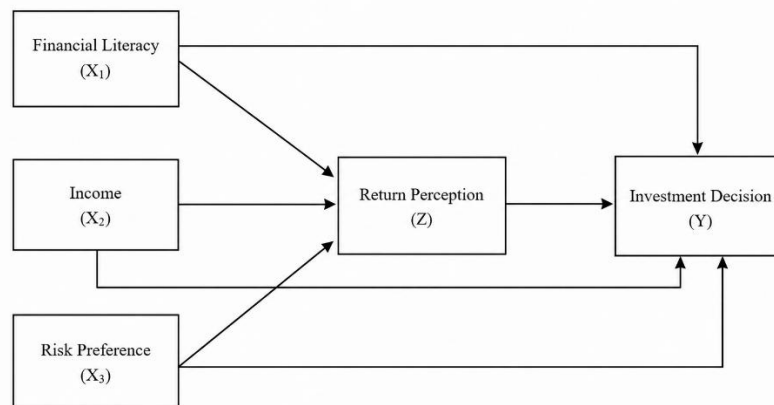
## ***Investment Decision***

Investment decisions result from the interaction of rational and psychological factors, including financial literacy, income, risk preference, and return perception (Kristianti & Kristiana, 2023). Previous studies have shown mixed findings, highlighting the importance of positioning return perception as a mediating variable to better explain these relationships (Sunarko & Sutrisno, 2025).

## ***Hypotheses***

Based on the literature review and previous empirical findings, the following hypotheses are proposed:

- H1.** Financial literacy has a positive and significant effect on investment decisions among millennial investors in Yogyakarta.
- H2.** Income has a positive and significant effect on investment decisions among millennial investors in Yogyakarta.
- H3.** Risk preference has a positive and significant effect on investment decisions among millennial investors in Yogyakarta.
- H4.** Return perception has a positive and significant effect on investment decisions among millennial investors in Yogyakarta.
- H5.** Financial literacy positively influences investment decisions through return perception as a mediating variable.



**Figure 3. Research Model**

**H6.** Income positively influences investment decisions through return perception as a mediating variable.

**H7.** Risk preference positively influences investment decisions through return perception as a mediating variable.

## Methods

### *Sampling and Procedures*

The population of this study consists of millennial investors in Yogyakarta. Respondents were selected using purposive sampling, with the requirement that they had engaged in at least one investment activity. A total of 110 valid responses were collected through structured questionnaires distributed both online and offline.

### *Measures*

**Financial literacy** is the ability to understand basic financial concepts and to effectively manage personal finances, including income management, financial planning, and investment decision-making (Safriyani et al., 2020; Lusardi & Mitchell, 2020). This study measured financial literacy using eight questionnaire items adapted from Chen and Volpe (1998), consisting of four dimensions: basic financial knowledge, savings and loans, insurance, and investment.

**Income** is the amount of earnings an individual receives from various sources, such as salary, business activities, or investment returns, which determines the individual's financial capacity to allocate funds for investment (Reviandani, 2019). This study measured income using eight questionnaire items adapted from Reviandani (2019), covering four dimensions: regular salary income, bonuses and incentives, additional income, and investment returns.

**Risk preference** refers to an individual's tendency to respond to uncertainty and potential losses in financial and investment activities, reflecting whether the individual adopts a conservative or an aggressive approach toward risk (Pavlou, as cited in Abdillah, 2019). This study measured risk preference using four questionnaire items adapted from Abdillah (2019), covering two dimensions: the probability of experiencing losses and the presence of specific risks.

**Return perception** refers to an individual's belief regarding the expected level of return from an investment instrument based on personal experience and available information (Darmaji, 2016). This study measured return perception using six questionnaire items adapted from Darmaji (2016), covering three dimensions: dividends, capital gains, and bonus shares.

**Investment decision** refers to an individual's decision-making process in selecting, evaluating, and allocating funds to specific investment instruments with the objective of obtaining optimal long-term returns (Lestari et al., 2022). This study measured investment decision using six questionnaire items adapted from Tandelilin, covering three dimensions: return, risk, and time horizon.

## ***Data Analysis***

This study applied a quantitative research approach. Quantitative approaches utilize statistical techniques to analyze data drawn from defined populations and samples in order to test hypotheses (Sugiyono, 2019). In this research, SmartPLS 4.0 was employed to examine the effects of financial literacy, income, and risk preference on investment decisions among millennial investors in Yogyakarta, with return perception serving as a mediating variable. The analytical process was carried out in two main stages: outer model analysis and inner model analysis.

### **Outer Model Analysis**

The outer model was assessed to evaluate the validity and reliability of the constructs used in this study. According to Ghazali & Latan (2020), the outer model serves as a tool to measure the quality of indicators in representing latent variables. Several criteria were applied in this stage:

**Convergent Validity:** Convergent validity was examined through standardized loading factors and Average Variance Extracted (AVE). Indicators are considered valid if their loading factor values exceed 0.70 and AVE values are greater than 0.50. This ensures that each indicator strongly reflects the construct it measures.

**Discriminant Validity:** Discriminant validity was tested to confirm that each construct is distinct from others. This was achieved by comparing the correlation of indicators with their respective constructs against correlations with other constructs. Valid discriminant values indicate that constructs are uniquely measured and not overlapping.

**Composite Reliability:** Composite reliability was used to assess internal consistency. A construct is considered reliable if the composite reliability value exceeds 0.70, indicating that the indicators consistently measure the same latent variable.

**Cronbach's Alpha:** Cronbach's Alpha was also applied as an additional measure of reliability. Values greater than 0.70 demonstrate acceptable reliability, confirming that the measurement items are stable and consistent.

### **Inner Model Analysis**

The inner model, also referred to as the structural model, was evaluated to determine the predictive power and the strength of relationships among the latent variables in this study. Several criteria were applied in this stage:

**R-Square ( $R^2$ ):**  $R^2$  values were calculated to measure the explanatory power of independent variables on the dependent variable. In this study,  $R^2$  indicates how much variance in investment decision is explained by financial literacy, income, risk preference, and return perception. Values of 0.75, 0.50, and 0.25 are interpreted as strong, moderate, and weak explanatory power, respectively.

**Q-Square ( $Q^2$ ):**  $Q^2$  values were used to evaluate predictive relevance. A  $Q^2$  value greater than 0 demonstrates that the model has good predictive relevance, while values below 0 suggest poor prediction. This ensures that the structural model is capable of predicting the relationships among constructs.

## Hypotheses Testing

Hypotheses testing was conducted to evaluate the relationships between the independent variables (financial literacy, income, and risk preference) and the dependent variable (investment decision) with return perception as a mediating variable. Two main criteria were applied:

**Path Coefficient:** Path coefficients were examined to identify the strength and direction of the hypothesized relationships. Values close to +1 indicate strong positive effects, while values close to -1 indicate strong negative effects. This analysis shows how financial literacy, income, and risk preference influence investment decisions directly, as well as indirectly through return perception.

**t-Statistic:** The significance of each path was tested using T-statistics. Results were compared against the critical T-table value of 1.98 at a 5% significance level ( $p < 0.05$ ). If the T-statistic exceeds 1.98, the hypothesis is considered supported; if it falls below, the hypothesis is rejected. This ensures that only statistically significant relationships are accepted in the model.

## Result and Discussion

### Result

#### Outer Model Analysis

The outer model was evaluated to examine the validity and reliability of the measurement model before testing the structural relationships. The assessment included convergent validity, discriminant validity, Average Variance Extracted (AVE), Composite Reliability, and Cronbach's Alpha.

**Table 1. Measurement and Structural Model Assessment**

| Construct           | Outer Loading | AVE   | Cronbach's Alpha | CR    | $R^2$ | $Q^2$ |
|---------------------|---------------|-------|------------------|-------|-------|-------|
| Financial Literacy  | 0.797–0.897   | 0.729 | 0.947            | 0.956 | -     | -     |
| Income              | 0.756–0.869   | 0.686 | 0.934            | 0.946 | -     | -     |
| Risk Preference     | 0.863–0.893   | 0.777 | 0.857            | 0.913 | -     | -     |
| Return Perception   | 0.848–0.892   | 0.764 | 0.938            | 0.951 | 0.913 | 0.665 |
| Investment Decision | 0.814–0.872   | 0.731 | 0.926            | 0.942 | 0.937 | 0.618 |

*Convergent Validity*

Convergent validity was assessed using the outer loading values. All indicators have loading values ranging from 0.756 to 0.897, exceeding the recommended threshold of 0.70. These results indicate that each indicator adequately represents its corresponding latent construct. Therefore, all indicators meet the requirements of convergent validity and are retained for further analysis.

*Discriminant Validity*

Discriminant validity was evaluated using the cross-loading criterion. The loading value of each indicator on its respective construct is higher than its correlations with other constructs. This demonstrates that each construct is empirically distinct and measures different concepts, indicating satisfactory discriminant validity.

*Average Variance Extracted (AVE)*

The AVE values range from 0.686 to 0.777, all exceeding the minimum recommended value of 0.50. Specifically, the AVE values are 0.729 for Financial Literacy, 0.686 for Income, 0.777 for Risk Preference, 0.764 for Return Perception, and 0.731 for Investment Decision. These findings indicate that each construct explains more than half of the variance of its indicators, confirming adequate convergent validity.

*Cronbach's Alpha*

Cronbach's Alpha values range from 0.857 to 0.947, all exceeding the minimum acceptable value of 0.70. These results further confirm that all constructs possess good internal consistency reliability. Overall, the measurement model satisfies the requirements of validity and reliability, indicating that the proposed constructs are appropriate for evaluating the structural model.

*Composite Reliability*

Composite Reliability values range from 0.913 to 0.956, indicating high internal consistency among the indicators measuring each construct. Since all values exceed the recommended threshold of 0.70, the constructs demonstrate satisfactory reliability.

**Inner Model Analysis**

The structural model was evaluated using the coefficient of determination ( $R^2$ ) and predictive relevance ( $Q^2$ ). As presented in Table 1, the  $R^2$  value for Return Perception is 0.913, indicating that Financial Literacy, Income, and Risk Preference explain 91.3% of the variance in Return Perception. Likewise, the  $R^2$  value for Investment Decision is 0.937, suggesting that Financial Literacy, Income, Risk Preference, and Return Perception jointly explain 93.7% of the variance in Investment Decision. These values indicate that the proposed structural model has substantial explanatory power.

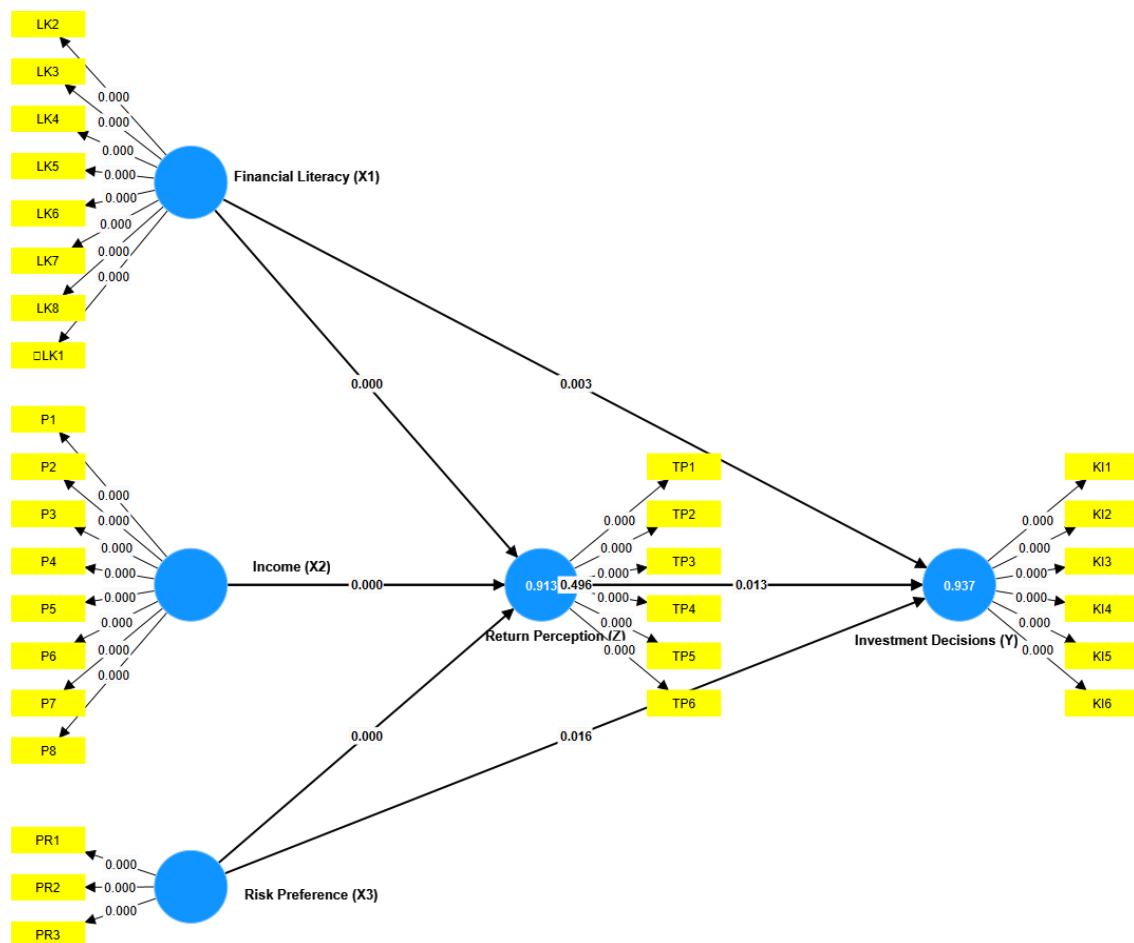
The predictive relevance of the model was assessed using the Stone-Geisser  $Q^2$  value. Return Perception obtained a  $Q^2$  value of 0.665, while Investment Decision achieved a  $Q^2$  value of 0.618. Since both values are greater than zero, the structural model demonstrates satisfactory predictive relevance. Overall, these findings indicate that

the proposed model has strong explanatory capability and adequate predictive accuracy for explaining investment decisions among the respondents.

### Hypothesis Testing

Hypothesis testing results indicate that three of the four direct relationships proposed in this study are statistically significant. Financial literacy has a significant positive effect on investment decisions ( $\beta = 0.282$ ,  $t = 2.929$ ,  $p = 0.003$ ), indicating that higher financial literacy encourages better investment decisions. Therefore, H1 is supported. Income, however, does not significantly affect investment decisions ( $\beta = 0.078$ ,  $t = 0.681$ ,  $p = 0.496$ ), indicating that income alone is not sufficient to explain investment decisions among the respondents. Thus, H2 is not supported. Risk preference has a significant positive effect on investment decisions ( $\beta = 0.198$ ,  $t = 2.402$ ,  $p = 0.016$ ), suggesting that respondents with a higher willingness to take risks tend to make stronger investment decisions. Therefore, H3 is supported. In addition, return perception has a significant positive effect on investment decisions ( $\beta = 0.441$ ,  $t = 2.493$ ,  $p = 0.013$ ), indicating that individuals who perceive higher investment returns are more likely to make investment decisions. Accordingly, H4 is supported.

The indirect effects were also examined to evaluate the mediating role of return perception. The indirect effect of financial literacy on investment decisions through



**Figure 4. Output Bootstrapping**

return perception is not statistically significant ( $\beta = 0.138$ ,  $t = 1.920$ ,  $p = 0.055$ ). Therefore, H5 is not supported, indicating that return perception does not mediate the relationship between financial literacy and investment decisions. In contrast, income has a significant indirect effect on investment decisions through return perception ( $\beta = 0.173$ ,  $t = 2.581$ ,  $p = 0.010$ ), suggesting that higher income contributes to better investment decisions by improving return perception. Therefore, H6 is supported. Likewise, risk preference has a significant indirect effect on investment decisions through return perception ( $\beta = 0.127$ ,  $t = 2.047$ ,  $p = 0.041$ ), indicating that return perception partially mediates the relationship between risk preference and investment decisions. Thus, H7 is supported.

Overall, the results show that five of the seven proposed hypotheses are supported, while two hypotheses (H2 and H5) are not supported. Among the direct relationships, return perception has the strongest influence on investment decisions ( $\beta = 0.441$ ). These findings suggest that return perception plays an important role in investment decision-making among millennial investors in Yogyakarta, both as a direct predictor and as a mediating variable that strengthens the effects of income and risk preference.

## **Discussion**

The results confirm that financial literacy has a positive and significant effect on investment decisions. This indicates that the ability to understand basic financial concepts, evaluate risks, diversify portfolios, and recognize investment instruments plays a crucial role in shaping rational investment behavior. Millennials with higher financial literacy are more likely to make calculated investment choices. These findings are consistent with Hariputra & Rita (2023) and Lusardi & Mitchell (2020), who emphasize the role of financial literacy in investment participation.

Income was found not to have a significant effect on investment decisions. Although the relationship is positive, higher income does not automatically lead to stronger investment activity. This suggests that income alone is insufficient without financial knowledge and risk awareness. The findings align with Bongomin et al. (2020) and Putri & Rahyuda (2022), who argue that income is secondary compared to financial literacy and return perception. However, this result contrasts with Lusardi & Mitchell (2020), who found that higher income increases investment participation.

Risk preference has a positive and significant effect on investment decisions. Millennials with higher risk tolerance are more likely to invest, perceiving potential gains as outweighing possible losses. This supports Prospect Theory (Kahneman & Tversky, 1979), which explains that individuals frame investment decisions based on subjective perceptions of gain and loss. The findings are consistent with Nguyen et al. (2021) and Hariputra & Rita (2023), who highlight that risk-tolerant millennials invest more aggressively compared to conservative investors.

Return perception has a positive and significant effect on investment decisions. Millennials who perceive higher potential returns are more inclined to invest, making return perception a dominant factor in decision-making. This result supports Ahmad & Shah (2022) and Phan & Zhou (2023), who found that expected returns strongly influence investment behavior, particularly in high-risk instruments.

The indirect effect of financial literacy through return perception was not significant. This suggests that financial literacy influences investment decisions directly rather than through shaping return perception. Millennials with strong financial knowledge

tend to make investment decisions independently of their perceptions of return. This finding is consistent with Bongomin et al. (2020) and Putri & Rahyuda (2022), who argue that financial literacy acts as a direct determinant of investment behavior.

Income indirectly affects investment decisions through return perception. Although income alone is not significant, when mediated by return perception, it becomes a significant factor. This indicates that higher income fosters more optimistic perceptions of return, which in turn drives investment decisions. The findings align with Phan & Zhou (2023), who highlight return perception as a psychological mechanism bridging economic conditions and investment behavior.

Risk preference indirectly influences investment decisions through return perception. Millennials with higher risk tolerance tend to form more optimistic expectations of returns, which motivates them to invest. Conversely, risk-averse individuals perceive returns more conservatively, reducing their likelihood of investing. This finding is consistent with Khan, Tan, & Chong (2022), who found that risk tolerance shapes return expectations and thereby influences investment intensity.

## Conclusion

Based on the results of data analysis and discussion regarding the influence of financial literacy, income, and risk preference on investment decisions with return perception as a mediating variable among millennial investors in Yogyakarta, the following conclusions can be drawn:

- ☑ Financial literacy has a positive and significant effect on investment decisions among millennial investors in Yogyakarta.
- ☑ Income does not have a significant effect on investment decisions among millennial investors in Yogyakarta.
- ☑ Risk preference has a positive and significant effect on investment decisions among millennial investors in Yogyakarta.
- ☑ Return perception has a positive and significant effect on investment decisions among millennial investors in Yogyakarta.
- ☑ Financial literacy through return perception does not have a significant effect on investment decisions among millennial investors in Yogyakarta.
- ☑ Income through return perception has a positive and significant effect on investment decisions among millennial investors in Yogyakarta.
- ☑ Risk preference through return perception has a positive and significant effect on investment decisions among millennial investors in Yogyakarta.

## Limitation

This study has several limitations that should be acknowledged. First, the research was conducted only among millennial investors in Yogyakarta, which restricts the generalizability of the findings to other regions or broader populations with different socio-economic and cultural contexts. Second, the use of purposive sampling and self-reported questionnaires may introduce bias, as respondents could provide socially desirable answers or misinterpret questions. Third, the cross-sectional design captures data at a single point in time, limiting the ability to observe behavioral changes or establish causality between variables. Fourth, the study

focused only on financial literacy, income, risk preference, and return perception, while other factors such as financial technology adoption, peer influence, market volatility, and cultural attitudes were not included but may also play significant roles in shaping investment behavior. Finally, the reliance on quantitative analysis without deeper qualitative insights may overlook nuanced psychological or contextual factors influencing millennial investment decisions. These limitations suggest that future research should employ larger and more diverse samples, longitudinal approaches, and incorporate additional variables to provide a more comprehensive understanding of investment behavior.

### ***Management Implication***

The results of this study provide several important management implications for stakeholders in the financial sector, particularly policymakers, financial institutions, and educators. Since financial literacy has been proven to significantly influence investment decisions, management should prioritize initiatives that strengthen financial education among millennials, such as structured training programs, workshops, and accessible digital learning platforms. The finding that income does not directly affect investment decisions but becomes significant when mediated by return perception implies that management must focus on shaping realistic and positive perceptions of investment returns through transparent product information, effective communication strategies, and personalized advisory services.

Furthermore, the significant role of risk preference suggests that management should design investment products tailored to different levels of risk tolerance, offering both conservative and high-risk options to accommodate diverse investor profiles. The strong influence of return perception highlights the importance of building investor confidence by providing accurate market insights, simulations, and tools that help millennials evaluate potential returns. Overall, these implications emphasize that management efforts to improve financial literacy, manage risk tolerance, and foster constructive perceptions of return can collectively encourage rational and sustainable investment behavior among millennial investors, thereby supporting broader financial inclusion and economic growth.

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