Hedging Against Embarrassment

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Propósito Central do Trabalho:
Individual investors often must reveal to others the outcome of their investments—e.g., a spouse who knows s/he will eventually have to communicate the performance of their stock portfolio to the significant other. Surprisingly, little is known about impact of public versus private outcomes on individual investors’ decisions (Lakonishok et al. 1991). In this paper, we systematically address this issue. Precisely, we investigate whether the expected disclosure (vs. secrecy) of investors’ performance outcomes influences one of the most common and robust anomalies in behavioral finance, the so-called disposition effect (Dhar and Zhu 1996, Shefrin and Statman 1985, Odean 1998) The disposition effect refers to investors’ tendency to sell the stocks that have increased in value relative to the purchase price and to hold the stocks that have decreased in value relative to the purchase price. In two experiments, participants make a series of investment decisions in a stock market simulation knowing that their final financial performance will either be made public or kept private. Independent of market trends or payoff structures, the results consistently show a significant increase in the disposition effect in the public condition—mainly due to a spike in the realization of paper gains. Participants’ proneness to sell their gains in the public condition represents in part a strategic attempt to hedge against the embarrassment of ending the trading session at the bottom of the distribution.

Marco Teórico:
The disposition effect (DE) represents one of the classic anomalies in behavioral finance (Shefrin and Statman 1985). Relative to the purchase price, people are more prone to sell assets that have increased in value than they are to sell assets that have decreased in value. Although it is difficult to explain on rational grounds, this phenomenon has been demonstrated in conventional stocks markets, e-trading and behavioral and neuroeconomic labs. Analyses at the individual level show that investor expertise tends to reduce the DE (Dhar and Zhu 2006). Nonetheless, the DE has, in general, been shown to be prevalent across markets and cultures. The phenomenon has been observed in Australia, Finland, Japan, and Taiwan, among other countries. We rely on this well-established effect to address a yet unexplored research avenue in financial decision making—the extent to which investors’ decisions, and consequently the DE, vary when the investors are aware that their financial performances will be made public (vs. kept private). Consciously or not, an individual will naturally attempt to influence how others perceive him/her. These self-presentation or impression management concerns and tactics have been shown to impact people’s feelings, thoughts, judgments, and decision-making. Consumers, for instance, feel more embarrassed when buying condoms next to strangers than alone (Dahl, Manchanda, and Argo 2001) and choose a greater variety of goods in public than in private because they expect the variety to be more valued by others (Ratner and Kahn 2002). There is also evidence that at least some institutional investors also use impression management strategies when it comes time to disclose their financial performance to their clients. For instance, Lakonishok at al. (1991) showed that pension funds—particularly the small ones at the end of the fourth quarter—are disproportionally more likely to sell their poorly performing holdings to dispose of what the client would likely see as a ‘bad bet’. Similarly, Hertzberg, Liberti, and Paravisini (2010) showed that loan officers are more likely to self-report bad news when it is expected to have a lower impact on their career prospects. In those cases, however, the “window dressing” strategies are often explained by sheer financial reasons (e.g., avoid losing a client or avoid losing a job) rather than self-conscious emotions (see below). Further, none of them focus on
its overall impact on the DE. We argue that self-presentation to peers should impact the individual investor’s in a stock market setting. Furthermore, it might happen at least in part through the anticipation of self-conscious emotions (Tangney and Fisher 1995). Because investors tend to believe that skills rather than sheer luck determines financial performance in the stock market, the pride of a successful investment decision or the embarrassment of a failed one in front of peers could have a strong anticipatory impact on their decisions in stock market settings.

Método de investigação se pertinente:
Two experiments are conducted in which participants make buying and selling decisions in a 30-period stock market simulation. Participants start the experiment with R$10.00 and are given the opportunity, on each period, to buy and sell one or several of the 6 stocks available in the market. Participants are informed that the market trends for each stock have been randomly obtained from the BOVESPA stock market. Participants are paid based on their performance (cash + stocks) at the end of the stock market simulation. The disposition effect was computed following Odean’s (1988) procedure. First, for each period, the stocks were classified into four categories: “realized gains” (“losses”) for the stocks that were sold after having increased (decreased) in value relative to the purchase price and “paper gains” (“losses”) for the stocks that were not sold after having increased (decreased) in value relative to the purchase price. The frequency of winning and losing stocks sold and held in each period was counted, and the proportion of gains and losses realized was computed. The disposition effect coefficient (DC) of investor i is then DCi = PGRi – PLRi. This coefficient is in the range between –1 and +1, inclusive. A positive value of DCi indicates that a larger proportion of gains is sold compared with the proportion of losses sold, in which case investor i exhibits the disposition effect. The analyses above can be conducted at either the individual or aggregate level. At the individual level, the proportion of gains and losses realized by each participant is computed and then averaged across participants. At the market level, the proportion of realized gains and losses is based on the total sum of realized gains and losses and paper gains and losses of all participants in a given market (or condition). Note that whereas the individual level of analysis generates four means of proportions and the unit of analysis is the participant (hence, a relatively small sample size), the market level analysis generates four actual proportions, and the unit of analysis is the share (hence, a much larger sample size). ANOVAs and t tests were used in individual analysis, whereas z tests for comparing proportions were used in the market level analysis.

Resultados e contribuições do trabalho para a área:
The results of the first experiment show that the participants made different financial decisions in the stock market simulation when they expected their performance to be made public compared to the situation in which they expected their performance to be kept private. Independent of the type of analysis (individual or market level), two conclusions can be drawn. First, there is an increase in the disposition effect in the public condition relative to the private condition. Furthermore, the effect is primarily driven by an increase in people’s propensity to sell the stocks that have increased in value relative to the purchase price. In experiment 2, the results replicate the main phenomenon observed in experiment 1—that is, an increase in the DE in the public condition that was mainly driven by an increase in the realization of gains. In short, the effect holds independent of the payoff structure (continuous payment, experiment 1, vs. tournament, experiment 2) and market trends. Furthermore, experiment 2 provides evidence that the participants sold their gains in a strategic attempt to hedge against the embarrassment of ending the trading session among the “poor performers.” Consistent with this rationale, the spike in the realization of gains disappeared when
anticipated embarrassment was unlikely to take place (only top 3 to be made public). This result is true despite the fact that the likelihood of experiencing pride is still present. In short, the realization of gains in the public setting appears to have been an attempt to avoid the bottom rather than to approach the top. Finally, it is worth noting that when public embarrassment was unlikely, a reversal of the disposition effect was observed in the aggregate analysis. Although this is beyond the scope of the current research enterprise, we suspect that the use of a tournament (rather than a continuous payment) might have contributed to this effect. At a broad level of analysis, there are some apparent inconsistencies in the finance literature in regard to investors’ propensity to realize gains relative to losses. Whereas investors are typically more inclined to hold losses relative to gains in general (Odean 1998), some findings suggest that they are more prone to sell losses relative to gains before presenting the portfolio to clients (Lakonishok et al. 1991). We speculate that the differences in the focus of attention might explain the discrepancy. Whereas in the former case the investors may be more focused on overall ROI, in the latter, they are focused on the individual stocks in the portfolio. Thus, in a setting where individual investors anticipate revealing their performance to their peers, we expect the DE to be strong when the focus is on overall earnings (as in experiments 1 and 2). However, if people expect revealing the performance of each stock in the portfolio, than the reversal of the DE becomes a possible consequence as individual investors attempt to keep the good assets and get rid of salient bad ones—the standard window dressing effect. Future research could also investigate this possibility.

Referências bibliográficas: