

Discussion of

**“Initial Returns and Stock Market
Re-Entry Decisions”**

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Contribution

- **We can divide people into four categories:**
 1. *Never invests in individual stocks*
 2. *Begins investing in individual stocks and remains invested*
 3. *Begins investing in individual stocks but stops investing temporarily*
 4. *Begins investing in individual stocks but stops investing “permanently”*
- **Classic literature** explains “stock market” participation (stocks and mutual funds) in terms of participation costs, risk aversion, etc.
- **Newer literature** shows default options influence participation and asset allocation decisions within retirement savings plans
- **Newest literature** studies impact of (**plausibly exogenous**) asset returns on asset allocation decisions → **lower returns predict exit**
- **This paper studies re-entry decisions of 9,435 Finns, 1995-2003**
Main finding: Lower **initial** returns are also associated with less re-entry
Interpretation: Initial returns overweighted (“Primacy effect”)

Measuring Returns

- **Authors decompose investor returns during window with positive stock holdings into**
 - *Initial return* = return in month 1
 - *All return* = average return during months 1-T
 - *Recent return* = return in month T
 - Primacy → Coef. on IniRet will be positive and significant
 - Recency → Coef. on RecRet will be positive and significant
- **Table 4: Primacy matters for re-entry across specifications**

VARIABLES	Model 1	Model 2	Model 3	Model 4
	Re-entry			
IniRet	0.4881*** (3.20)	0.4754*** (3.11)	0.5325*** (3.55)	0.4056*** (2.61)
AllRet	0.4409*** (2.85)	0.4155*** (2.69)	0.2519* (1.74)	0.2415* (1.75)
RecRet	-0.2168*** (-2.77)	-0.2045*** (-2.62)	-0.1130 (-1.54)	-0.1120 (-1.60)

Measuring Returns (2)

- **Saliency?**
 - *If I want immediate feedback on the my stock picking ability, why would I focus on the return during the first month?*
 - *Why not the first day, week, or quarter? On the first statement?*
- **Endogeneity?**
 - Initial returns plausibly exogenous in IPO lottery or when returns on default option largely driven by market returns
 - In this setting, initial buy likely reflects (perceived) information
 - *Are investors learning about expected return on single stock, type of stock, or universe of stocks?*
 - *What happens if authors define re-entry as buying any stock that was previously held (as opposed to buying any stock)?*
- **Different Scales?**
 - *Why are coefficients on market return ~30 times larger than on initial return?*

Sample Selection

- **The authors understand they are studying a non-random sample of investors**
 - Study 9,435 investors who first buy stock after their sample period begins... and sell all of the shares before the sample period ends
 - *Criteria is likely to rule out anyone who attempts to construct a diversified portfolio...*
 - *... unless person engages in an extreme form of market timing*
- **Authors' approach is to estimate Heckman correction term and add it to their logit specification**
 - Instrument in selection equation is dummy variable indicating if investor inherited stock in past 12 months
 - *How common is inheritance? Is it a weak instrument?*
 - *Minor: Could inheritance trigger re-entry?*
 - Probably more efficient to estimate joint likelihood function (e.g., Dubin and Rivers (1989))

Policy Relevance

- **What is the underlying economic question?**
 - Fraction of investors eligible for re-entry is small (9,435 / 97,539)
 - If insight is that some exit is temporary, authors could study how initial return impacts probability of any positive holdings after 12, 36, and 60 months? → *refinement of existing literature*
- **Why stock holdings?**
 - Authors: “several problems with mutual funds that may prevent investors from reaping the premiums offered by equity markets”
 - **71%** of those who exit invest in a single stock → *bad mutual fund can offer significant diversification benefit relative to single stock*
- **“Our findings highlight the particular relevance of financial literacy to increased stock market participation”**
 - This is very interesting... *but existing evidence is indirect*
 - Include interactions with other proxies for literacy? With IQ?