How Past Performance Framing Impacts Investors' Belief Updating

(Patrick Gerhard, Arvid Hoffmann, Thomas Post)

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* Views expressed are personal opinions

Strengths

Interesting research

Clean experiment, clear description

Not only return expectation but also risk perception

Experiment

Authors present respondents past investment returns when probing for next month's

- expected return ("expect good return in next month")
- risk perception ("expect investing to be risky in next month")

Three options for opening screen showing past returns for:

- last year
- last month
- last day

Clicking to alternative screens (returns) is very easy

Literature and hypothesis

Two strands of literature:

1) Longer investment horizon → less conservative investment portfolio's
   (message longer horizon is beneficial)
2) Larger updates of beliefs → more trading → worse performance

Hypothesis: Framing in terms of longer horizons → smaller belief updates

Relevance:

If hypothesis holds then presenting different horizons may influence investor performance

Findings

1. Longer horizon in opening screen → Smaller belief updates (for non-clickers)
2. Longer horizon in last viewed screen → Smaller belief updates (for clickers)

Thus, strong evidence in favor of hypothesis (longer horizon → smaller belief updates)

Authors suggest that this result is conforming previous evidence

Reading the literature overview, this claim seems quite <u>modest</u>

- this paper is the first that demonstrates this relation empirically ('selling point')
- what it confirms is that longer horizons have positive effects

Clicking (opting out) and financial literacy

The authors find that clicking is positively related to financial literacy, meaning that literacy seems a curse for those who have an opening screen with annual returns

However, if you believe stock returns follow a random walk: clicking is a waste of time as past returns are irrelevant for future returns!

Is it really literacy or is it confidence in financial skills?

If you believe past returns are informative: one should click to all three screens!

- How often does this happen?
- Do respondents show consistent click behavior, i.e. always click to the same screen?

Missing information on returns!

Show daily, monthly, and annual returns used in experiment!

I assume

- All respondents face the same returns
- The returns are consistent
    - across the period of measurement (e.g. monthly vs quarterly)
    - across rounds (e.g. annual return round 6 includes previous monthly returns)

This needs to be clarified in the paper

Note: Figure 1 provides one example of a screen plot.
However, the percent change does not seem to be consistent with the change in euro!

Be careful for framing in experiment!

The experiment is framed in terms of monthly expectations.

Indeed, respondents opt out less often from monthly opening screen (only 27%).

Respondents may search for this information or not, depending on the framing.

What are the consequences for the results?

Is there evidence that investors think in terms of monthly returns?

Suggestions future research

Study considers two situations: those who stick to the default vs those who click away from the default

However, one may click to exactly one other screen (simple opt-out); or one can click to all three screens to collect as much information as possible (elaborate opt-out).

How many participants do click to all three screens, i.e. collect as much information as possible?

Analyze, this group separately!

Are smaller updates due to lower probability of updating, due to smaller size of updates or both?

Narrative is missing

What are possible explanations for longer horizon → smaller updates expected return

What are possible explanation for longer horizon → smaller updates expected risk

An intuitive explanation: smaller changes in annual return from month to month induce smaller updates

Are there alternative explanations?

Annex: Remarks on Table 2 regressions

Regression of the updates size (either positive or negative) on the difference in returns.

Interpretation of coefficients: 1 percentage point higher return (annual?)
→ 2.6 higher on 1-7 scale "expect good return in next month"
→ 1.7 lower on 1-7 scale "expect investing to be risky in next month"

Is this interpretation correct? Pretty large effects.

Are the returns annualized to make them comparable for daily, monthly, annual format?

Is there a difference across formats: last screen daily, monthly, annual returns

Risk perception may not be refer to volatility risk but to probability of negative returns?