Stock Market Expectations and Risk Aversion of Individual Investors

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Abstract

We study the relationship between stock market return expectations and risk aversion of individuals and test whether the joint effects arising from the interaction of these two variables affect investment decisions. Using data from the Dutch National Bank Household Survey, we find that risk aversion levels have significant and negative effects on stock market expectations. We identify significant and negative effects on stock market participation arising from the interaction between stock market expectations and risk aversion. These effects are in addition to a significant and positive impact from stock market return expectations as well as a significant and negative effect from risk aversion separately. However, once individuals participate in the stock market, their stock market expectations alone remain significant in determining their portfolio allocation decisions.

Keywords: Portfolio Allocation, Stock Market Expectation, Risk Aversion, Individual Investor.

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