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"Rookies to the stock market: A portrait of new shareholders"

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ABSTRACT

This study examines individuals entering the stock market, "rookies." The study uses unique ownership data, containing investor holdings of all listed Swedish firms over the sample period from 2004 to 2010, to examine rookies' stock portfolios. In addition, this study explores investor sophistication among rookies, based on individual characteristics and portfolio composition. Although the average shareholder is aging and leaving the stock market, this study shows there are signs of rejuvenation, with rookies entering the stock market. The results show that the majority of rookies hold under-diversified stock portfolios and choose one large firm as their first stock market investment. Rookie characteristics display gender differences, in which the average female rookie has lower income, is older, but holds a larger stock portfolio than her male counterpart.

1. Introduction

For decades the numbers of individual stock market investors have been declining. Davis (2009) reports that in the U.S., individual investors are dying. In order for individual stock market investors not to be eradicated over time, and to mitigate the ailing trend, rejuvenation is needed. This study analyses the development of individual stock market investors, and possible rejuvenation, with focus on new stock investors (henceforth rookies). The study aims to show the existence of rookies, as well as to fill in a piece of the puzzle of who the rookies are.

Individual investors, in general, are considered less sophisticated, with bias limiting their success in trading, compared with institutions. Prior studies focus on the trading behavior of individual investors (e.g., Barber and Odean 2000, 2001; Goetzmann and Kumar 2008), but knowledge on rejuvenation among individual stock market investors is limited. Rather, several studies show that the numbers of individual investors are declining and might have a diminishing future on the stock market (e.g., Lease et al., 1974; Davis 2009; Rydqvist et al., 2014). The present study analyses whether the decline in the numbers of shareholders is an isolated U.S. problem or if a similar pattern can be detected in Sweden too. Furthermore, no previous study has shown whether the decline in numbers of shareholders is due to the non-existence of rookies or if the stock market attracts rookies but nonetheless has a declining trend. Even though the results presented in this study support the declining trend of stockholdings directly owned by individual investors, there is evidence of rookies moving into the stock market. Thus, this study shows that the reason for the ailing trend is not because there are no new shareholders investing in the stock market, but rather that the decline is mitigated by rookies. Furthermore, this study reveals characteristics and stock portfolio preferences of rookies. Previous studies portraying individual investors have been undertaken on a small scale. For example, De Bondt (1998) presents a portrait based on 45 investors and Durand et al. (2008) study 18 investors. In contrast,

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the present study is based on a dataset containing all individual shareholders in Swedish listed firms (approximately 1.9 million stock market investors).

De Bondt (1998) argues for two main reasons for studying individuals' actions in the stock market rather than their beliefs. First, investment by the individual affects well-being. Second, with individuals assuming ever-larger responsibility for their own pensions, the future well-being of retirees is affected. In Sweden, the responsibility for pension savings has shifted, from the government, towards the individual in recent decades. Holding shares is common in Sweden. According to Guiso et al. (2003), 50 percent of households in Sweden own shares, which is a similar proportion to the U.S. Barber et al. (2009) show that individual investors' trading is driven by active own decisions and not as a reaction to institutional trading. Together, this supports the study of individual stock market entrants separately to institutions. This study focuses on rookies, their directly owned shares, and their entry to the stock market.

The study explicitly targets rookies and their stock market portfolios when entering the stock market. Thereby, this study focus on a previously overlooked group of investors, the rookies. Although previous research question the future of individual stock market investors, no previous study addresses rookies. The results of this study support previous research, showing a decline in the number of individual investors holding shares. However, this study also shows that rookies are entering the stock market, with possibilities of rejuvenation among stock market investors. Furthermore, this study portrays rookies and their first stock portfolios, which contributes to previous portraits of individual investors (e.g., De Bondt, 1998; Durand et al., 2008). The study supports previous research reporting under-diversification among individual shareholders, with most stock portfolios consisting of stocks from only one or a few firms. In addition the study reveals gender differences: female rookies enter the stock market later in life but with larger proportions of their income, and hold slightly larger numbers of stocks in their portfolios compared to male rookies. To the best of our knowledge, there are no previous studies on stock market rookies. The remainder of the paper proceeds as follows. The following Section 2 describes this study in relation to prior studies. Section 3 describes the data and methodology. Section 4 presents the results, and Section 5 concludes.

2. Literature review

Lease et al. (1974) show that individuals have been net sellers of shares in the U.S. from 1959. Schlarbaum et al. (1978) extend the timeframe to 1978, with the same pattern of individuals being net sellers. Furthermore, Rydqvist et al. (2014) show that ever since World War 2, there has been a shift from direct shareholdings by individuals to holdings through institutions. Rydqvist et al. (2014) present the development for the U.S. and show that individuals who directly held shares declined from 90 percent to one third of the stock market. Together, the studies show that, at least in the U.S., individual investors are declining with no rejuvenation or recovery in sight; despite this, there is a lack of studies on rookies.

Considering the gender of investors, Lease et al. (1974) find that 80–90 percent of investment decision makers are men. A similar gender balance can be drawn from Cohn et al. (1975) and Tekçe et al. (2016). Barber and Odean (2001) show that individuals typically expect their stock portfolios to outperform the market. Although male investors have the highest expectations, both male and female investors expect to outperform the market. Odean (1998) describes traders as overconfident, and therefore, carrying dead weight losses, since they trade too frequently and overreact to irrelevant information. In addition, Tekçe and Yilmaz (2015) study investor overconfidence in Turkey, and their results support those of Odean (1998) with males, young, low-income, and low-education investors being the most overconfident. Furthermore, Tekçe and Yilmaz (2015) state that overconfidence has negative effects on portfolio wealth. Barber and Odean (2001) show that men overtrade more than women do, and thereby lose more money due to transaction costs. Barber and Odean (2000) also show that individual investors underperform against relevant benchmarks. In their dataset, Barber and Odean (2000, 2001), proxy the gender of the investor by identifying the name of the person who opened the household's account. However, in this study, the individual characteristics of the shareholders are used, and this gives the opportunity to ask other questions, considering the age, income and gender of the shareholder, rather than anyone within a household.

Hoffmann et al. (2013) study individual investors and their behavior during the financial crisis of 2008–2009. The authors report that individual investors continue to trade, seeing the falling market as an opportunity to buy cheap stocks rather than investing in other products. Burnie and De Ridder (2009) use the same source of ownership data as in the present study. However, Burnie and De Ridder (2009) focus on the institutional ownership structure in Sweden over 2000 to 2002. Their study provides some support for the displacement of individual shareholders in favor of institutions. The results of Burnie and De Ridder (2009) and Rydqvist et al. (2014) together suggest that the pattern in Sweden is similar to that of the U.S., with individual shareholders diminishing in favor of institutions.

Individual investors are described as under-diversified (e.g., Blume and Fried 1975; Kelly, 1995; Mitton and Vorkink, 2007; Goetzmann and Kumar, 2008). Considering the 30-plus stocks as a cut-off for diversified stock portfolios (Statman, 1987), most individuals are severely under-diversified. In fact, only 0.04 percent (98 of 243,866 individuals, not reported) of the rookies hold 30 stocks or more in Sweden. Goetzmann and Kumar (2008) find evidence for investors diversifying deliberately, when holding more than one stock. They report that investors pick passive diversification when holding more than one stock.

Studies of investors in the Nordic countries (Denmark, Finland, Iceland, Norway and Sweden) have an advantage over U.S. studies regarding data availability because the former have identification numbers for every citizen (equivalent to social security numbers) and openness of government authorities, which enable researchers to access information and decode personal information. Utilizing Swedish data, Massa and Simonov (2006) show that investors earn strong returns