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The effect of early and salient investment experiences on subsequent asset allocations – An experimental study

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Abstract

In two experiments on sequential asset allocation decisions between a safe and a risky asset, we find that an early market crash leads subjects to invest less in a risky asset in later periods, a result that is mediated by gender. In the first experiment subjects who experience a market bust early in the investment lifecycle invest less in a risky asset compared to subjects who experience a market boom, even when the subjects receive the exact same return stream over twenty periods. In the second experiment we manipulated the size and timing of the market crash and find that the “size” of a bust matters more than its timing. Changes in beliefs about future stock market returns correlate strongly with short-term changes in stock allocations but cannot explain the persistence of decreased stock allocations for subjects exposed to early market crashes in contrast to some prior literature.

Keywords: Behavioral Finance; Booms and Crashes; Investment Decisions; Financial Experiences; Laboratory Experiments

JEL Classification: G01; G02; G11; G12

PsycINFO Classification code: 3920

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