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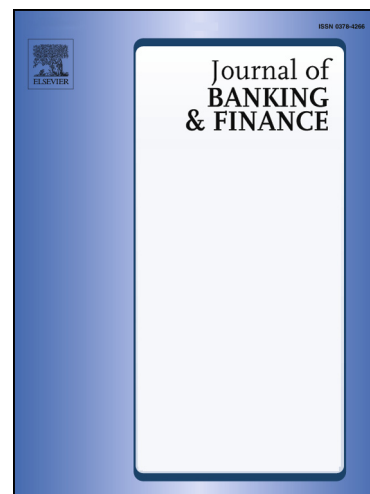
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How Does Pricing Affect Investors' Product Choice?

Evidence from the Market for Discount Certificates

Oliver Entrop¹, Georg Fischer², Michael McKenzie³,
Marco Wilkens⁴, and Christoph Winkler⁵

Abstract

This paper examines the choices of retail investors in the market for structured financial products with a focus on implicit and explicit pricing components. We evaluate more than 72,000 single stock discount certificates on a daily basis from 2004 through 2008. The certificates are quoted an average of 0.58% above their fair value before the financial crisis, increasing to 1.24% during 2008. Although credit risk explains a major part (39%) of the certificates' overpricing, we find that issuer default risk does not have any influence on investors' product choices. Instead, retail investors are strongly influenced by irrational factors such as issuer and product familiarity. Finally, investors are found to make poor product choices (in terms of bid/ask spreads and markups over fair value), resulting in significant losses.

Keywords: Structured products; Derivatives; Investor behavior; Product pricing

JEL Classification: G11, G12, D83

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