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Christoph Merkle, Martin Weber

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Do Investors Put Their Money Where Their Mouth Is? Stock Market Expectations and Investing Behavior*

Christoph Merkle[†], Martin Weber[‡]

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Abstract

To understand how real investors use their beliefs and preferences in investing decisions, we examine a panel survey of self-directed online investors at a UK bank. The survey asks for return expectations, risk expectations, and risk tolerance of these investors in three-month intervals between 2008 and 2010. We combine the survey data with investors' actual trading data and portfolio holdings. We find that investor beliefs have little predictive power for immediate trading behavior. The exception is a positive effect of increases in return expectation on buying activity. Portfolio risk levels and changes are more systematically related to return and risk expectations. In line with financial theory, risk taking increases with return expectations and decreases with risk expectations. In response to their expectations, investors also adjust the riskiness of assets they trade.

JEL-Classification Codes: D81, G02, G11

Keywords: Expectations, Beliefs, Risk, Return, Trading Behavior, Portfolio Choice

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[†]Chair of Finance and Banking, University of Mannheim, L5, 2, 68131 Mannheim, Germany (corresponding author: chmerkle@mail.uni-mannheim.de, Phone: +496211811531, Fax: +496211811534.)

[‡]Chair of Finance and Banking, University of Mannheim, L5, 2, 68131 Mannheim, Germany

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