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Are risk-seekers more optimistic? Non-parametric approach[☆]

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ABSTRACT

Class and field surveys revealed that personal inclination to take structured lottery-risk significantly correlates with optimism in financial forecasting. Trait optimism reflects in return predictions for successful and problematic stocks, in likelihood assessments of specific events, and even when respondents recollect past realizations. Gain-domain risk preference shows the strongest predictive power for forecast positivity, even when macro expectations, win-chance optimism and personal attributes are controlled. The correlations are strongest when optimism scores are derived from multiple prediction tasks, but quickly dissolve when subjects receive usable anchors. The findings are discussed in light of optimism scope and recent research on ambiguity aversion.

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1. Introduction

The distinction between conditions of risk, where the probabilities of outcomes are objectively known, and cases of uncertainty (Knight, 1921) or ambiguity (Ellsberg, 1961), where chances are unclear, still draws wide interest in economic research. Recent studies, in particular, suggest that receptiveness to risk correlates with positive ambiguity attitude (e.g., Bossaerts et al., 2007; Lauriola et al., 2007; Chakravarty and Roy, 2009; Charness and Gneezy, 2010), and trait optimism was proposed as possible explanation (Trautmann and van de Kuilen, 2013).¹ With this motivation, the current study investigates the link between risk appetite and forecast positivity, testing if risk-tolerant individuals hold more optimistic beliefs regarding future economic uncertainties.

We take a non-parametric approach to the examination, disconnecting from formal theories of choice when characterizing the tendency to take risk, and mixing over diverse domains, methods and frames while assessing relative forecast positivity.

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¹ Bossaerts et al. (2007) show that diversification patterns correlate under risk and ambiguity, while Charness and Gneezy (2010) demonstrate that subjects that select into ambiguous markets allocate higher proportion to risky investment. Chakravarty and Roy (2009) use multiple price lists, finding positive significant correlation in gain-domain. Lauriola et al. (2007) prove that such correlations emerge even when the conditions are run in separate semesters.

The paper may thus classify as a correlational study, where on one hand we measure risk-preference in structured lottery-choice assignments and on the other we approximate personal optimism with respect to economic or financial uncertainties. Since positive correlations may arise or withdraw from mediating effects such as gender, wealth, or education, we control for these and other confounds, also testing if risk-preference appears to boost optimism beyond general macro expectations.

Additional motivation arrives from the interdisciplinary interest in optimism. Psychology studies treat optimism as a rather stable personality trait, using customary questionnaires such as LOT-R (Scheier et al., 1994) to measure life-course expectations. The choice literature definition (see, Hey, 1984 for earlier discussion; Dillenberger et al., 2012 for recent example) disconnects from the personal perspective, defining optimism in terms of subjective beliefs over events that are far beyond the control of the decision maker. Empirical studies utilize other, ad hoc, definitions; e.g., Puri and Robinson (2007) use the difference between expected life spans and actuarial estimates, showing that optimistic individuals work longer, save more, and exhibit stock-picking behavior. The expanding literature demonstrates that optimists use short-term debt extensively (Landier and Thesmar, 2009); adopt tougher positions in bargaining (Dickinson, 2006); show increased likelihood of mortgage arrears (Dawson and Henley, 2012) and discount the future less heavily (Shavit et al., 2013). From the optimism-definition standpoint, our study explores the scope of personal positivity, testing if optimism jointly reflects in remote domains such as experimental lottery-choice and case-specific economic forecasting.

We have run two incentivized surveys that did not mention the words optimism or pessimism and were introduced as studies of macroeconomic and stock-market expectations. Psychometric tests of optimism such as LOT-R were avoided to decrease the risk that participants recognize the main research question.² The first shorter questionnaire ($N=75$) was distributed in large dining centers to attract participants of diverse background. The second comprehensive survey ($N=73$) was run in MBA classes. Both studies revealed positive significant correlations, around 0.45, between relative forecast-optimism and individual inclination to take experimental lottery-risk. The proportion of risky choices in gain-domain problems emerges as the most significant predictor of forecast-optimism in both studies, although the risk-preference elicitation tasks were very different. The correlation is strongest at the aggregate, when optimism is evaluated with respect to multiple prediction targets, but it quickly dissolves when a numeric anchor is provided with the forecasting assignment. More generally, the predictive power of personal risk-preference for forecast-positivity appears to significantly strengthen with underlying target uncertainty. The correlation is highly significant when respondents predict the few-years performance of volatile stocks, but it almost dissolves in predictions of monthly returns on heavy stock indices. Our results, with this respect, support the cognitive or informational account of dispositional optimism, beyond the motivational explanation (Coelho, 2010). Optimistic types tend to retrieve or access more positive evidence when contemplating forecasts. As the dispersion of signals increases with underlying uncertainty, the distance between the forecasts of optimistic risk-seekers and pessimistic risk-aversers rises in parallel.

Optimism studies sometimes distinguish between “trait optimism” representing the basic dispositional inclination and “state optimism” which may be affected by temporary conditions (e.g., Burke et al., 2000). Generally optimistic individuals come out relatively pessimistic in particular contexts where state-related effects override their fundamental positivity (Kluemper et al., 2009). Indeed, Wengler and Rosén (2000) find that life-events optimism shows only moderate correlation with optimism regarding worldwide events. If economic predictions are strongly influenced by personal states while risk attitudes are relatively immune to transitory effects (Harrison et al., 2005; Sahm, 2007; Zyphur et al., 2009), then the forecasts of risk-seekers may not appear more optimistic. The 0.45 correlations between gain-domain risk chasing and forecast-optimism are therefore rather surprising. While the correlations could follow from universal tendency of optimistic individuals for positive expectations (in choice and in prediction), a control for “win-chance optimism” could not explain the results. Respondents that overestimated their success rates in repeated coin-flips took more risk in the lottery-choice assignments, but the hypothesis that “win-chance optimism” mediates the correlation between forecast-optimism and risk-preference was rejected for both surveys.³

Interestingly, our results for loss-domain risk-preferences are negative. When the gain-domain measures are replaced by parallel loss-domain risk-tolerance scores, the correlations between risk-preference and forecast-positivity strongly deteriorate. As part of the psychology literature treats optimism and pessimism as distinct constructs (Chang et al., 1997), we also test if gain-side risk-preference is a stronger predictor of positive-domain optimism, while loss-side risk-preference obtains stronger correlations with negative-domain forecasts (e.g., predictions of the loss on problematic stocks). The refined hypothesis, however, is clearly rejected for both surveys. The weaker results for loss-domain choices are attributed to the lower levels of consistency and higher noise that generally characterize loss-related decisions (e.g., Abdellaoui et al., 2013).

Together with preceding research, the results of our surveys propose that the positive correlation between risk and ambiguity attitudes may have two distinct roots. Abdellaoui et al. (2011) show that risk-receptive individuals exhibit relatively optimistic choice patterns under uncertainty, when personal beliefs are controlled. The results of the current paper additionally propose that the risk-tolerant generally hold more optimistic views in cases of uncertainty. In uncertain investment

² We suspected that if the survey is perceived as an optimism study, self-classification and experimenter demand effects might bias results. Following a referee comment, we distributed the LOT-R to survey II participants about 2 years later. 50% responded. LOT-R positively correlated with risk-preference, but did not correlate with forecast optimism. The details are provided in Section 4.4.

³ As risk-preferences are rather stable, while forecast-optimism may vary with selected uncertainties and personal states, we treat optimism as the dependent variable throughout the analysis.

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