Discussion of “Foregone Consumption and Return-Chasing Investments”

Agarwal-Charoenwong-Gosh

Amir Kermani (Berkeley & NBER)

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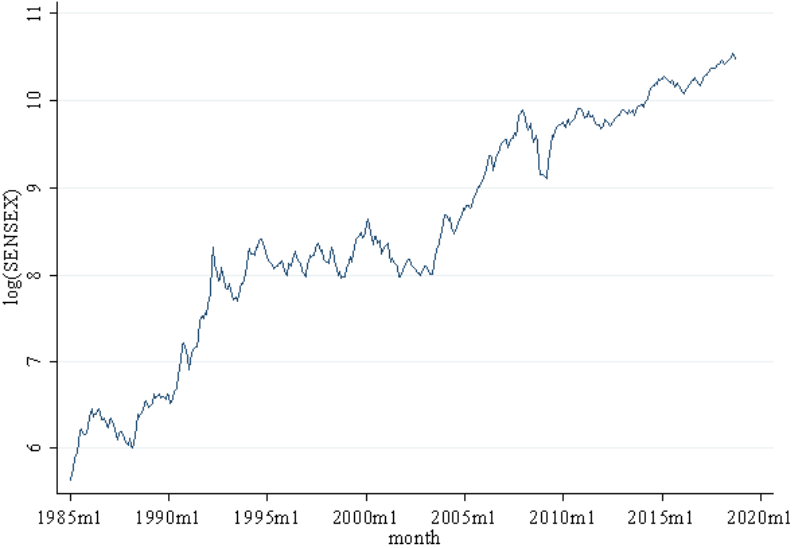
Main Question: How households consumption and saving is affected by stock returns?

- Wealth effect: to the extent that there is any wealth effect, higher stock wealth increases household consumption.
- Expectation channel: the decision of saving/consumption is also function of expected return.

$$u'(c_t) = \beta E_t \left[\tilde{R}_{t+1} u'(c_{t+1}) \right]$$

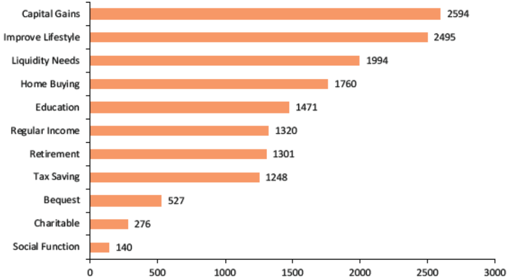
  - If stock investment is the main margin of adjustment for the household and households have extrapolative expectations, then higher monthly returns can be associated with lower consumption.
- So whether higher stock returns is associated with lower consumption or higher consumption is function of:
  - Time horizon
  - Investors expectation

India Stock Market



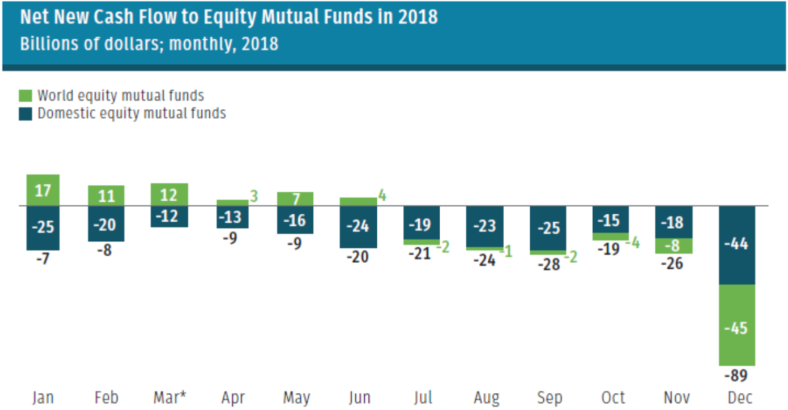
Why Do Investors Invest in the Stock Market?

Figure 4.2: Why do Households Invest

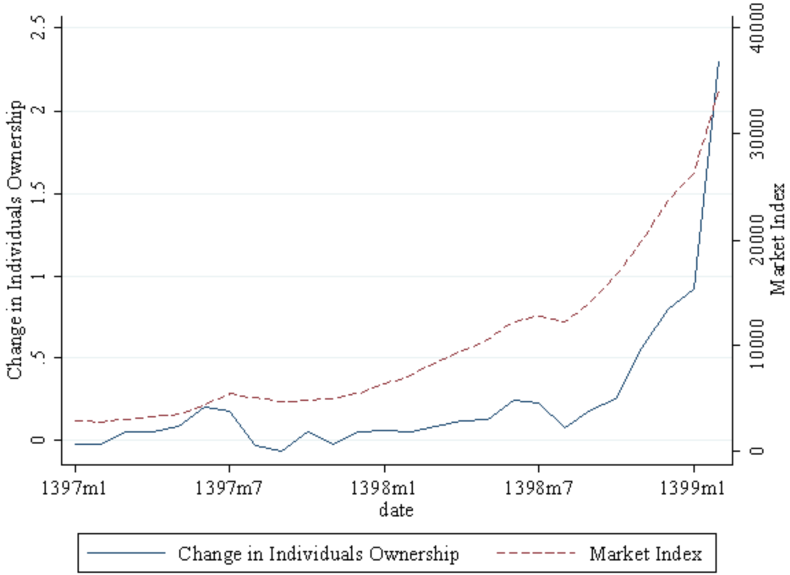


N = 5,356 (all urban investor, SIS 2015). Optional question answered by 5,313 investors.
Respondents could check multiple options.

Related Pattern for Mutual Funds in the US



Similar Pattern in Iran



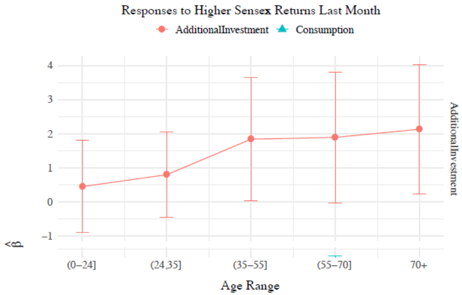
Comment 1: Better Use of Data and Better Identification

- Current specification is using variation in the aggregate market return.
    - There are 21 months in the data. half of them with positive return and the other half with negative returns.
    - This makes the usefulness of the very interesting detailed micro-level data very limited.

- A better specification:

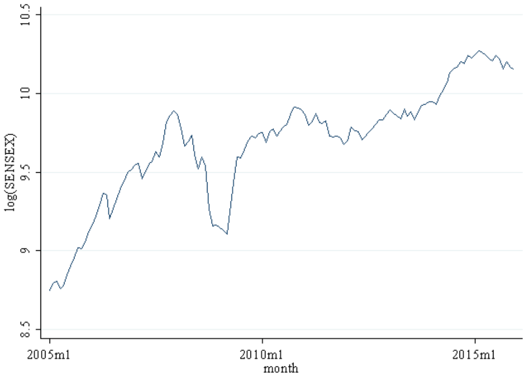
$$\Delta c_{it} = \beta_1 SW_{i,t-1} \times r_{t-1} + \beta_2 SW_{i,t} \times r_t + \phi_1 r_{t-1} + \phi_2 r_t + X_{it-1}\Gamma + \epsilon_{it}$$

Comment 2: Does Experience Affect Extrapolative Behavior?



- There are two episodes of extreme market returns: 1989-1992 , 2003-2006.
- Is being around in those years associated with more extrapolative behavior?

Comment 3: Try to Expand Time-Series



- Having a short time-series affects the power of tests significantly.
- There are significantly larger and more interesting movements in 2006-2010.

Comment 4: Negative vs. Positive Returns

- What is the rational for differential response to negative shocks vs. positive shocks?
  - The patterns on flows from other countries suggest that flows are also sensitive to negative market returns.
  - My guess: it is mostly about the size of the movements rather than the direction.
  - Another reason for asking for a longer time series.