

Impact of Price Path on Disposition Bias

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Abstract

Recent experimental studies have illustrated the influence of price-path, particularly the 'non-straight' price-path on several aspects of investor behavior. The paper computes a proxy for price-path based on Cumulative Prospect Theory and with investor-level high frequency trade data from the commodities futures market, demonstrates that the nature of the price-path significantly impacts the degree of disposition bias, after controlling for the level of returns and volatility of the commodity. We find that the experience of a favorable (unfavorable) price-path, decreases (increases) disposition bias among the traders with Prospect Theory preferences. The decline (increase) in disposition bias is an outcome of the decline (increase) in the propensity for gain realization, accompanied by a concurrent increase (decline) in the propensity for loss realization among the traders. We conjecture that both investor preferences and beliefs about future price movement, inferred from the price-path experienced, influence their trading decisions.

Speaker Profile

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