

Some gains are riskier than others: Volatility changes, belief revisions, and the disposition effect

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Abstract

I examine whether an increase in a stock's volatility during the holding period triggers a revision in investors' beliefs as to the stock's risk level. This revision makes loss-averse investors more willing to sell a riskier stock with a paper gain as the likelihood of having to sell it at a loss later increases. An analysis of a large dataset on the holdings and trades of individual investors yields empirical support for this prediction: a one standard deviation increase in volatility is associated with an 11% increase in the disposition effect. The effect primarily emerges from investors' increased propensity to sell stocks with small paper gains.

Speaker Profile:

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