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The Behavior of Japanese Individual Investors During Bull and Bear Markets

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Abstract

We study Japanese individual investors by contrasting their behavior during a long bull market (1984-1989) to a long bear market (1990-1999). Our main objective is to test whether individuals' attitudes and preferences toward stock risk, book-to-market valuation, and past returns, are different between market conditions. We also assess individuals' investing performance. Overall, we identify some striking differences in investing behavior between the bull and the bear market. These behaviors are associated with poor investment performance. Some of our findings are consistent with existing behavioral theories, but some of our findings are not.

keywords:

overconfidence | individual investor behavior | bull and bear markets | Japan

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Notes

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∗∗, and ∗ denote statistical significance at the 1, 5, and 10 percent levels, respectively.

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[1] Kim and Nofsinger [2005] study how institutional trading differs between bull and bear markets, but their study is not about behavioral or cognitive biases.

[2]We also conduct analyses using only firms whose fiscal year begin in April (69% of our firms fit this criteria), but the results remain the same.

[3]The model of Daniel et al. [2001] provides a possible explanation for our risk findings. Their model suggests that less confident investors will use systematic risk measures as a signal for expected return. When investors become overconfident, like during a bull market, they may focus less on relevant or statistically-oriented information such as systematic risk measures. This might explain why Japanese individuals hold risky stocks primarily during a bear market instead of a bull market. However, we admit that we are merely applying a behavioral explanation to a result ex post, which is easy to do.

[4]To report portfolio t-statistics we estimate the following equation by year: Level = $\alpha+\delta\times$ Volatility. We use these annual estimates of α and δ during the 6 bull market years to compute t-statistics to test whether the coefficients are different from zero and report them in [brackets] in the top half of the table. As the bottom half of the table tests the difference between bull and bear market behavior, we conduct a difference in means test of the annual α and δ estimates between the 6 bull market observations and the 10 bear market estimates. The resulting t-statistics are reported in [brackets] in the bottom half of the table.