Research Seminar "Quantitative Economics"

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Abstract

Buy High, Cry Later: Beliefs-driven Cycles of Stock Market Participation
(Christian Heyerdahl-Larsen)

Abstract
Using survey data, we show that stock market participants are systematically more optimistic than nonparticipants, and that exit coincides with deteriorations in beliefs. Accordingly, we build a model with beliefs-driven participation cycles: inexperienced cohorts enter with high leverage during periods of market exuberance and exit during downturns. In equilibrium, experienced cohorts typically remain in the market, as the market-clearing risk premium tends to gravitate toward their beliefs. These interactions generate procyclical participation, endogenous feedback between participation and experience-based learning, and welfare losses. When fed with realized shocks, the model reproduces fluctuations in participation, entry, and exit rates across multiple countries.