Slow Sinkers Are the Real Stinkers: Why a Plummeting Stock Price Can Be Better For Investors Than a Gradual Decline

Neil Brigden, University of Alberta, Canada
Gerald Häubl, University of Alberta, Canada

Holding financial assets that perform only moderately poorly can have more negative implications than holding assets with rapidly declining value. While investors sell plummeting assets quickly, they hold “slow sinkers” for too long. Thus, having an asset they own decline sharply can ironically render consumers wealthier in the long run.

[to cite]:

[url]:
http://www.acrwebsite.org/volumes/1011850/volumes/v40/NA-40

[copyright notice]:
This work is copyrighted by The Association for Consumer Research. For permission to copy or use this work in whole or in part, please contact the Copyright Clearance Center at http://www.copyright.com/.
Slow Sinkers Are the Real Stinkers: Why a Plummeting Stock Price Can Be Better for Investors Than a Gradual Decline

Neil Brigden, University of Alberta, Canada
Gerald Häubl, University of Alberta, Canada

EXTENDED ABSTRACT

Choosing to sell a poorly performing financial asset can be difficult. Indeed, prior research has shown that investors tend to hold flagging assets for too long (Odean 1998; Shefrin and Statman 1985; Weber and Camerer 1998). This is in line with prospect theory (Tversky and Kahneman 1979) in that an asset that has lost value relative to a reference price is coded as a loss. Decision makers are risk seeking for losses, and therefore hold losing assets hoping they will recover.

However, investors do not hold sinking assets indefinitely. In particular, they do tend to respond to large price changes (Andreasen 1988). We hypothesize that an asset that declines rapidly can actually be better for the investor than one that declines slowly or stagnates. This occurs because the investor holding a rapidly declining asset is more likely to sell it quickly, while the investor holding a slowly declining or stagnating asset is more likely to continue to hold that poor asset. Compounding the effect, investors may become less likely to sell a poor asset the longer they hold it because of inaction inertia (Tykocinski, Israel, and Pittman 2004; Tykocinski, Pittman, and Tuttle 1995).

Inaction inertia refers to the decreased likelihood of taking an attractive course of action when a similar and superior course of action has been previously foregone (Tykocinski and Pittman 1998; Tykocinski et al. 1995). If investors do not sell a poorly performing asset initially, they are less likely to sell it in the future, because they compare the opportunity to sell with previous, superior opportunities.

We hypothesize that “slowly sinking” assets can be more costly to investors than assets that decline rapidly. However, the risk of sinking slowly can be reduced by preventing investors from maintaining their asset allocations via mere inaction – using an “forced-selling” intervention, whereby investors must actively choose how to invest their capital afresh each period.

To test these hypotheses, we conducted an experiment in which 152 participants played a consequential investment game. Participants were initially endowed with an investment portfolio worth $40,000 to invest over the course of the game. Upon completion of the experiment, all participants were paid 0.0005% of the final value of their portfolio.

The portfolio was initially divided evenly among four assets. In each of 20 periods, participants saw updated price information and could then reallocate the value of their investments across the four assets. Participants could not keep money out of the market as cash, nor could they borrow additional funds to invest.

All participants had one asset in their portfolio that was inferior to the other three in performance. The severity of the inferior asset’s poor performance was manipulated as either dramatically inferior (averaging -6% per period) or moderately inferior (averaging 0% per period). The other three assets were common to all participants and averaged returns of 1%, 3%, and 5% per period. All prices were determined individually for each participant and subject to random variations of plus or minus 3% per period.

In the standard-trading condition, participants continued to hold the same number of shares of each investment by default, unless they chose to sell. By contrast, in the forced-selling condition, all shares were sold at the end of each period, and participants had to allocate their entire capital across assets afresh.

As predicted, there was a significant two-way interaction between asset performance and condition $F(3, 148) = 8.346, p < .01$ (see figure 1). In the standard-trading condition, participants earned less money when their portfolio initially included the moderately inferior asset ($M = $77,834) than if it included the dramatically inferior asset ($M = $82,264), $t(75) = 2.05$, $p < .05$. By contrast, in the forced-selling condition, participants earned more when their portfolio initially contained the moderately inferior asset ($M = $85,514) than if it included the dramatically inferior asset ($M = $81,209), $t(73) = 2.04$, $p < .05$.

Figure 1: Final Portfolio Value (After 20 Periods) by Experimental Condition

We predicted that these effects would be driven by how investors respond to the inferior asset. When that asset declines rapidly, investors respond quickly, regardless of the selling manipulation, and sell those shares. By contrast, when the lowest performing asset has zero growth, investors’ responses depend on the selling manipulation. Under standard trading conditions, investors are slow to sell. The lack of growth does not attract much attention, and several periods may pass before investors realize that the asset is dragging their portfolio down. By that point, they have already missed several, more attractive, opportunities to sell the asset. Therefore, although selling now is still the normative action, it may appear relatively unattractive because it is being compared to superior, previously foregone opportunities.

Forced selling overcomes this inaction inertia trap because it requires investors to make an active asset allocation decision each period. Rather than deciding whether to retain an asset that has not increased in value, investors must decide whether to buy this poorly performing asset instead of an asset that has increased in value. Although these decisions are economically equivalent, they are very different psychologically and, as a result, they lead to different wealth states.

Figure 2 shows the number of inferior asset shares investors hold across all 20 periods. For both dramatically inferior conditions, and the moderately inferior, automatic selling condition, the pattern of results is almost identical. Participants sold most of their shares in the lowest performing asset within the first three periods. By con-
Contrast, in the moderately inferior, standard-trading condition, participants still had most of their shares in the inferior asset at the end of the fifth period. Over time, compounding growth amplifies the importance of these early decisions.

**Figure 2: Units of the Inferior Asset Held**

![Graph showing the number of units of the inferior asset held over time.](image)

The present research identifies a previously unidentified threat to investors – “slow sinkers” that perform moderately poorly, don’t attract attention, and tend to be held for too long, dragging down the value of consumers’ investment portfolios. The results of the forced-selling intervention pinpoint inaction inertia as the key psychological mechanism leading investors to hold “slow sinkers” for too long, and also identify an intervention that enhances consumer welfare by expediting the sale of investments that perform poorly without being spectacular losers.

**REFERENCES**


