



Does the framing of investment portfolios influence risk-taking behavior? Some experimental results [☆]

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Abstract

I examine the influence of the framing of investment portfolios on the risk-taking behavior of individual investors. Investment portfolios can be presented either in aggregated or segregated framing, meaning that either the overall distribution or the single investments of portfolios are displayed. Previous studies have found that simple lottery portfolios are more attractive if their overall distribution is displayed instead of the set of lotteries themselves. Investment portfolios differ from simple lottery portfolios because they are correlated and ambiguous. Which kind of investment portfolio framing leads to a higher acceptance by individual investors? Three experiments found that ambiguity and correlation of investment portfolios affect the extent of the framing effect. Framing effects are present under ambiguous risk and for positively-correlated portfolios. Furthermore, framing effects are observed mainly for individuals who decide intuitively rather than analytically.

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1. Introduction

Investment portfolios can be presented either in aggregated or segregated framing, meaning that either the overall distribution or the single investments of portfolios are displayed. For example, principal-protection mutual funds (also known as guarantee funds) are typically presented to individual investors in an aggregated framing. These funds are constructed as portfolios investing in a combination of existing investments such as stock options and zero bonds, and guarantee individual investors to get back their principals less charges. Although, in comparison with stock markets, these funds offer lower return rates in the long run, they often look more attractive to individual investors than the separate investments of these portfolios (Langer & Weber, 2001). The framing could be a possible explanation for many individual investors' preference for principal-protection mutual funds. An important question for contractors of bundled finance products such as mutual fund companies and banks is: Do investors consider an aggregated framed portfolio more attractive than a segregated framed portfolio?

Previous research did not examine framing effects and the risk-taking behavior of individual investors in the context of investment portfolios. A few experimental studies concerning the framing of lottery portfolios have shown that the acceptance of a sequence of lotteries is higher if the overall distribution is displayed instead of the set of lotteries themselves (Langer & Weber, 2001; Read, Loewenstein, & Rabin, 1999; Redelmeier & Tversky, 1992).

In Section 2, I give an overview of some studies which examine framing effects in identical and independent lotteries. Next, I present my results of three experimental studies concerning the influence of framing of investment portfolios on risk-taking behavior. In Section 4, I discuss implications for the framing of investment portfolios and suggest directions for further research.

2. Related literature: Framing effects in the evaluation of risky portfolios

To test the attractiveness of lottery portfolios as a function of segregated versus aggregated framing, Redelmeier and Tversky (1992) carried out a between-subject experiment. The subjects were asked to specify their acceptance of playing a lottery five times. This game was displayed either in a segregated or an aggregated framing. Most subjects (83%) accepted the lottery portfolio in the aggregated presentation mode, whereas fewer subjects (63%) accepted the portfolio in the segregated framing.

Kahneman and Lovallo (1993), Gneezy and Potters (1997), Benartzi and Thaler (1999) as well as Langer and Weber (2001) dealt with framing effects of risky and repeated lotteries. In their studies, loss aversion (as implied by Prospect Theory, Kahneman & Tversky, 1979) and mental accounting (Thaler, 1985, 1999) are the explanations for the framing effect of risky lottery portfolios. Aggregated framed portfolios are generally preferred to segregated framed portfolios. However, Langer and Weber (2001) found that this usual result is reversed in the case of lottery portfolios with moderate to low probabilities for rather high losses.

In investment decisions, probabilities are not generally well known, and they can easily change with new information, unlike in laboratory lottery decisions (Baron & Frisch, 1994; Camerer & Weber, 1992). As an example, Hogarth and Kunreuther (1985, 1989), Einhorn and Hogarth (1985), and Dow and Werlang (1992) demonstrate that 'unknown' probabili-

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