ARE STATED EXPECTATIONS ACTUAL BELIEFS? NEW EVIDENCE FOR THE BELIEFS CHANNEL OF INVESTMENT DEMAND

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There is a lot to admire

- Very interesting data
- Very careful empirical analysis
- Various setups that could be consistent with the result, but with a common thrust

The data input

- Data from the FRB NY Survey of Consumer Expectations, mostly housing module: 2015, 2020, 2021. They all include:
  - *Investment experiment of Armona et al. (2018) in SCE:*
    - Allocate $1000 between a 2% risk-free savings account and a housing fund tracking house price appreciation **“in your area”**.
    - Local focus: motivated by salience.
- **Further data:**
  - *SCE 2015-21: key results hold for some other responses, e.g., probability of buying investment properties.*
  - *A subsample of 2020-21 housing surveys with more direct questions on whether they base decisions on past returns or expected returns; and why.*

What does the paper do?

- Key finding: Perceptions of past housing returns have additional explanatory power for stated housing investment preferences and plans, despite controlling for
  - *subjective expectations of future house price growth*
  - *a number of factors, including controls for the subjective distribution of future house price growth*

- Central Interpretation: When it comes to investment decisions, which are complicated and for which respondents cannot trust their expectations very much, they prefer to rely more on (their perceptions of) past market returns.
  - *The decoupling of stated subjective expectations from actions has been noted as a possibility by Manski (2018).*

A number of robustness tests

- Results robust to controlling for
  - *risk aversion*
  - *omitted variable bias (demographics)*
  - *collinearity between return expectations and perceptions of past returns*
  - *measurement error in beliefs: instrumenting*
  - *controlling for aspects of the subjective distribution of returns*
  - *They ask half the sample if they rely more on expected returns or on their recollection of past returns:*
    - So, not survey noise or omitted variables.
  - *financial constraints:*
    - Past returns could have effects on financial constraints, but these do not enter the investment experiment

Interpretation of the key finding

- Model in which people who make complex decisions tend to rely on signals about which they are more certain:
  - *People shrink their stated forecast towards something about which they are more certain: "mental default". Enke and Graeber (2019)*
- They provide evidence that those who are less confident about their future forecasts relative to recalled past returns drive the result.
  - *But why are they more certain about the past? Maybe it is visible and salient?*
- They find that perceived past returns matter more than objectively measured past returns
  - *Consistent with importance of perceptions for individual behavior documented also in other studies*

Comment 1. An alternative vantage point

A glass half full

- Why do subjective expectations still matter when you control for perceived past returns that should be incorporated in them?
  - *One can examine which factors influence expected returns beyond perceptions of past returns.*
- For stock returns, Arrondel, Calvo-Pardo, Giannitsarou, Haliassos (2020) found that interactions with the inner peer circle (the “financial circle”) influence the accuracy of perceptions of past returns but not expectations conditional on perceptions.
- The authors could also examine what affects house price growth expectations beyond perceptions of past home price growth

2. Thinking about the interpretation

- Why do past returns matter when you are controlling for subjective expectations, which presumably take them into account?
  - *In the traditional approach you would not include them*
  - *Author argument: respondents upweight perceived experiences "as they feel more salient" to them.*
- But why wouldn't you do this for forming subjective expectations, too?
  - *"Whether driven by complexity, financial risk, or sparsity, the end result is that because of differential stakes when reporting forecasts versus making consequential financial decisions, agents may weight factors differently in each domain."*
    - So, they decide for something about which they care, and they get flustered
  - *But why do they care about a product tracking local house prices?*
    - Possibly because they want to keep up with their local peers
- Is it the noisiness of the signal for the response that is different or is it the relevance of house price growth for a different dimension of the decision?
  - *Future returns versus relative status (e.g., Roussanov relative wealth concern)*

An alternative interpretation

- **Local house appreciation points to how much the housing wealth of peers has grown.**
  - Concern about the relative position could encourage me to participate in a fund tracking the wealth of my neighbors
  - So, perceived past house price growth is not only relevant for my expectations of future growth but also for how much my neighbors have gained and how important it is to invest in a fund that enables me to keep up with the Joneses

How would the alternative fit the findings? 1

- Out of all robustness checks, the only one that “fails” is for renters:
  - *renters are more likely to be interacting with renters*
  - *and without housing wealth, their real estate wealth has not fallen behind*
- The effect of past returns is more pronounced for less financially literate people:
  - *They tend to be left behind, as they don’t take advantage of investment opportunities (cf. recent work on wealth returns: Bach et al (2020), Fagereng et al (2020a,b), Haliassos, Jansson, Karabulut (2021)*
- The effect of past returns is more pronounced for less informed people
  - *They need a tracking product more in order not to fall behind*

How would the alternative fit the findings? 2

- Subjective past experience is more salient to investors than their forecasts which have yet to occur
  - *Yes, because they represent losses in relative position*
- Past home price growth also helps predict intention to buy a non-primary residence
  - This will boost relative wealth
- Personal experience as a driver of investment decisions (Malmendier-Nagel):
  - *Consistent also with relative position concerns in this case*