Do Survey Expectations of Stock Returns Reflect Risk-Adjustments?

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Summary

- Objective: to rationalize documented departures of subjective expectations from rational expectations.
  - For instance, investors’ return expectations are pro-cyclical, whereas in RE framework representative investor perceives counter-cyclical expected returns.

Summary II

- Two potential explanations:
  - Risk-neutral expectations: outcomes are weighted by their probabilities X the marginal utility associated with each outcome → *More weight to outcomes in high MU states*.
  - Ambiguity aversion or concerns about model misspecification: give rise to *pessimism bias*.

Summary III

- Testable implication 1: expected returns should equal the risk-free rate.

- Testable implication 2: survey expected returns should be downward biased relative to RE of returns.

Summary IV

- Use data from a variety of surveys, spanning CFOs, wealthy investors, and professional investors.
- Find little support for either hypothesis.
- Instead, “In boom times, […] investors are too optimistic. Following crashes, […] investors are too pessimistic.”

Comments

- Very interesting topic and paper, carefully done.
- Growing literature on survey measures of expectations, subjective expectations, and departures from the FIRE framework.
- Contribution 1: come up with testable implications of two prominent rationalizations of departures from FIRE.
- Contribution 2: document empirical properties of subjective expectations of financial asset returns.

Comments II

- Authors briefly discuss point vs. density forecasts.
- Can still derive measures of central tendency from DFs; better inter-personal comparability.
- Pessimism Hp. could have testable implications for the tails/skewness of the subjective density forecasts.

Comments III

- What is the psychological mechanism that leads agents to assign a higher probability to outcomes in high MU states? Is it risk-aversion? Robust control considerations?

- How does this hypothesis relate to the pessimism hypothesis?

Comments IV

- Do any of these surveys have a panel dimension? (Assume Duke CFO survey does)

- Could think of additional tests of rationality, involving individual revisions of expectations and forecast errors.

Comments V

- The conditional tests of the risk-neutral expectations hypothesis use the P/D ratio as a conditioning variable.
  - Would be good to see robustness using other possible conditioning variables, e.g. state of the economy.
- "In boom times, [...] investors are too optimistic. Following crashes, [...] investors are too pessimistic."
  - Seems consistent with *diagnostic expectations*.