Understanding Retail Investors: Evidence from China

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Discussion by Darwin Choi
Retail Investors

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  - Barber, Odean, and Zhu (2009), Kaniel et al. (2012), Kelley and Tetlock (2013), Boehmer et al. (2021): Retail investors correctly predict future returns and trade accordingly
  - Barber et al. (2021), Eaton et al. (2021), Welch (2021): Robinhood investors perform well and engage in attention-induced trading
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- Different subgroups of retail investors behave differently

- Using Chinese data, this paper examines the heterogeneity of retail investors
Retail Investors in China

- Retail investors are important in China
  - Contribute 85% of daily trading volumes
  - Tens of millions of retail investors, accounting for the largest population of retail investors in the global market

This paper uses data from the Shanghai Stock Exchange. Trading and holdings data of 53m retail accounts in 2016–2019. Categorized into 5 groups by account balances (RT1–RT5). Also institutional investors (INST) and corporations (CORP). Small retail investors (RT1–RT4) negatively predict future returns, but large retail investors (RT5) and INST positively. Previous papers mostly treat retail investors as one group. Explanations: order flow persistence, liquidity provision, behavioral biases, and information (dis)advantages.
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#1: The Grouping

To comply with regulatory requirements, all Chinese retail accounts are categorized into five groups by account balances: less than 100,000 CNY (RT1), between 100,000 and 500,000 CNY (RT2), between 500,000 and 3,000,000 CNY (RT3), between 3,000,000 and 10,000,000 CNY (RT4), and greater than 10,000,000 CNY (RT5).
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- The grouping is crucial: RT5 is very different from the rest
- Can the authors provide more information?
- What exactly are the regulatory requirements? Why 5 groups? How are the cutoffs determined? Do investors know? Are there any differential treatments from the exchange (say, RT5 receive some discount in trading fees)?
#2: The Transition Across Groups

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- If it is the current balance, some of the results can be contaminated by the transition across groups.
  - Account balance is influenced by past performance and deposit/withdrawal.
- For investors whose balance is near 10m CNY (cutoff for RT5):
  - Those who performed well in RT4 move up to RT5.
  - Those who performed poorly in RT5 move down to RT4.
  - (Should not be a big problem as most investors do not switch groups because of past performance.)
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Retail investors deposit/withdraw money and cross the threshold:
- RT4 deposit/withdraw money and become RT5/RT3
- Depositing and withdrawing can be a function of past performance/skill
#3: Behavioral Biases

- Why does order flow predict returns?
- Persistence, Liquidity, Behavioral Biases, Other (Information)
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- **Persistence, Liquidity, Behavioral Biases, Other (Information)**

## Table

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<thead>
<tr>
<th>Dep.var</th>
<th>Ret OibRT1</th>
<th>Ret OibRT2</th>
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<th>Ret OibRT4</th>
<th>Ret OibRT5</th>
</tr>
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<tbody>
<tr>
<td>Oib(-1, Persistence)</td>
<td>Estimate</td>
<td>-0.0333***</td>
<td>-0.0279***</td>
<td>-0.0220***</td>
<td>0.0022</td>
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<td></td>
<td>[t-stat]</td>
<td>[-15.84]</td>
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<td>[-3.11]</td>
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<td>Oib(-1, Overconf)</td>
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<td></td>
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<tr>
<td>Oib(-1, Gamble)</td>
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<td>-0.0155</td>
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<td>[t-stat]</td>
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<td>-0.0058***</td>
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I am not sure if the stock-level turnover measure is a good proxy for overconfidence. Suppose RT3’s turnover for Bank of China stock is high. The proxy suggests that RT3 investors are overconfident about their ability in trading Bank of China stock (not in other stocks). High turnover can be a result of RT3’s attention on Bank of China too. Maximum daily returns as a proxy for gambling preferences can be affected by the 10% price limit.
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**Investor Attention**: Baidu Search Index (equivalent to Google Search Volume Index)

**Disposition Effect**: A proxy for aggregate unrealized capital gains constructed from price and turnover data (Grinblatt and Han, JFE 2005)
#4: Who’s in RT5?

- Account balance: > 10m CNY, 235,000 accounts (0.4% of the total)
- Mostly male, age > 45

Finnish underaged accountholders are extremely successful at picking stocks (Berkman, Koch, and Westerholm, JF 2014)

Can some RT5 be underaged investors?

Or hedge fund managers managing other people’s money?

Do RT5 trade against RT1–RT4 (a wealth transfer)?

The information channel can be consistent with the following:

For example, psychological and/or institutional frictions cause RT1–RT4 to hold stocks that are difficult to analyze. RT5 focus on stocks that are easier to analyze.

Regress $O_{ib RT5}^{i, d}$ on $O_{ib RT1}^{i, d} - O_{ib RT4}^{i, d}$; negative coefficients suggest that RT5 trade against RT1–RT4.

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Understanding Retail Investors
May 26, 2022 10 / 11
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• Very interesting paper and results!
  
  • Examine the heterogeneity of retail investors using a rich dataset

• I encourage the authors to think more about
  
  • The regulations regarding the grouping
  
  • The transition across groups (past performance and deposit/withdrawal)
  
  • Additional behavioral bias proxies
  
  • Who are the largest retail investors and why they can outperform