Some (Mis)facts about Myopic Loss Aversion*

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Abstract

Gneezy and Potters (1997) run an experiment to test the empirical content of Myopic Loss Aversion (MLA). They find that the attractiveness of a risky asset depends upon the investors’ time horizon: consistently with MLA, individuals are more willing to take risks when they evaluate their investments less frequently. This paper shows that these experimental findings can be easily accommodated by the most standard version of Expected Utility Theory, namely a CRRA specification. Additionally, we use four different datasets to estimate a CRRA model and two alternative MLA versions, together with various mixture specifications of the two competing models. Our econometric exercise finds little evidence of subjects’ loss aversion, which provides empirical ground for our theoretical claim.

JEL Classification: C91, D81, D14

Keywords: Expected Utility Theory, Myopic Loss Aversion, Evaluation Period.

1 Introduction

Benartzi and Thaler (1995) propose Myopic Loss Aversion (MLA hereafter) as an explanation to the so-called equity premium puzzle. This term was coined by Mehra and Prescott (1985), when they estimate that investors should have relative risk aversion coefficients in excess of

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