

Beliefs-driven Stock Market Entry and Exit *

Paul Ehling[†]
BI

Christian Heyerdahl-Larsen[‡]
BI

Zeshu Xu[§]
BI

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[†]Department of Finance, BI Norwegian Business School, Nydalsveien 37, 0484 Oslo, paul.ehling@bi.no

[‡]Department of Finance, BI Norwegian Business School, Nydalsveien 37, 0484 Oslo, christian.heyerdahl-larsen@bi.no

[§]Department of Finance, BI Norwegian Business School, Nydalsveien 37, 0484 Oslo, zeshu.xu@bi.no

Abstract

We study how learning from experience affects stock market participation in overlapping generations. During episodes of market exuberance and low risk premiums, the unexperienced enter the market often with high leverage exposing them to the risk of abruptly losing wealth, with the consequence being exit. On the contrary, experienced cohorts typically remain in the market despite pessimism. These patterns generate procyclical participation and feedback effects between participation and learning, amplifying fluctuations in interest rates and market volatility and lead to large welfare losses. Importantly, the model reproduces empirical evidence on participation, entry and exit from multiple countries.

Keywords: Endogenous Stock Market Participation, Stock Market Entry and Exit, Learning from Experience, Endogenous Learning

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