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Collateral damage: Mortgage crisis dampened zeal for stocks

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While many American families lost their homes during the U.S. subprime mortgage crisis, the housing market crash also induced some of the decline in the stock market as investors sold equities and never went back, say University of Michigan economists.

"During the recession of 2008-09, mortgage payment difficulties were a significant predictor of cashing in defined-contribution pension plans—an indirect way for families to sell off stock market holdings," said Frank Stafford, U-M professor of economics and research professor at the Institute for Social Research. "In 2001, before the stock market decline, 30 percent of families held stocks directly. By 2011, it is estimated than less than 20 percent held stocks directly."

Stafford and colleague Bing Chen, a recent doctoral graduate in economics, looked at the decisions of U.S. households to either hold or sell their non-pension stocks from 2007 to 2009.

"Studying what influences the decision to invest in stocks may help in understanding whether such transfer of responsibility in pension allocations and encouraging wider non-pension ownership is well justified or can be improved by better knowledge on the part of households," Stafford said.

Using data from the U-M Panel Study of Income Dynamics, the researchers found that the percentage of families owning stock fell from 25 percent in 2007 to 22 percent in 2009. The value of stocks owned fell from $232,900 in 2007 to $194,900 two years later.

In all, 29 percent fewer families held stocks in 2009, compared to 2007, before the housing-fueled recession began.

"During this period, changing participation costs arising from the need to reassess the future for equities and the end of a boom market affected households' portfolio decisions," Chen said.

The researchers looked at a slew of factors that could predict the likelihood that households would reduce their stock holdings during declining market conditions.

They found that the more education a family head had, the less likely the household was to have closed their stock account.

"People with some college or higher education are more knowledgeable and may believe they can weather the storm," Chen said. "They are also more likely to have stable jobs and better access to credit."

In addition, Stafford and Chen said that households with mid-range stock holdings—between $40,000 and $150,000—were more likely to exit the market than those with higher amounts.

"Households with mortgage distress were more likely to close their stock accounts presumably because they needed to money to pay their mortgage debts and living expenses," Stafford said. "However, while mortgage distress has shown a strong relation to participation and selling, it shows no strong relationship to capital losses in the stock market. This suggests that mortgage problems may not have been largely shaped by a general inability to manage finances.

"But with U.S. households—save the richest percent or two—holding about $6.5 trillion in equities, the induced decline in the stock market likely fed into the ongoing recession."

Provided by University of Michigan

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