

# Stock market bubbles: Investor emotions fuel the frenzy

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In the late 1990s, investor emotion played a significant role in inflating the dot-com bubble and ultimately, making a lot of people rich. Emotional excitement not only creates stock market bubble but research shows that the frenzy actually causes them to grow.

For the study's experiment, participants' emotions were stimulated by watching popular action films—such as *Mr. and Mrs. Smith* with Brad Pitt and *Angelina Jolie* playing married assassins—prior to making buying or selling stocks.

Forthcoming in the *Review of Finance*, 'Bubbling with Excitement: An Experiment,' is co-authored by Finance Prof. Terrance Odean, Haas Finance Group, along with Eduardo B. Andrade, professor at the Brazilian School of Public and Business Administration and Shengle Lin, assistant professor at San Francisco State University.

"We observed a lot of excitement in conjunction with real-world events such as the dot-com bubble and 'tulip mania' in 1637, and we wanted to see if people's high arousal would increase the size of the bubble," says Odean.

Their experiment compared investor behavior under three emotional states that varied in both intensity and whether they were positive or negative: excitement (high intensity and positive), calm (low intensity and positive), and fear ([high intensity](#) and negative).

The researchers recruited 495 participants from UC Berkeley's Xlab subject pool. Each experiment included nine participants who were given an allotment of cash and shares of a fictional asset to trade.

After three practice rounds of trading, each participant watched a video selected to induce one of the three desired [emotional states](#). Next, they answered two short questions about their

emotional state before proceeding to 15 rounds of trading.

The results: participants who experienced intense positive emotions prior to trading—for example, those who watched action films such as *Knight and Day* with Tom Cruise—were more aggressive, pushing prices up until the final rounds. Those who watched scary or movies—such as *Stephen King's Salem's Lot* or the environmental film, *Peace in the Water*—proceeded more cautiously.

Odean says the research increases our understanding of how bubbles work. "As asset prices went up and investors got excited, they were more likely to do uncritical buying and drive prices up more," he says. "In the real world, triggers for excitement could also lead to inflated prices, which is not necessarily a good thing when the bubble can burst."

**More information:** *Review of Finance*, [rof.oxfordjournals.org/content...jkey=4SBRv3Q9pIYQoF5](http://rof.oxfordjournals.org/content...jkey=4SBRv3Q9pIYQoF5)

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