Wealth Fluctuations and Risk Preferences: Evidence from U.S. Investor Portfolios∗

Maarten Meeuwis†

November 25, 2019

Job Market Paper

DRAFT AVAILABLE UPON REQUEST.1

Please email me at meeuwis@mit.edu for the latest version.

Future updates soon to be posted here.

Abstract

In a proprietary dataset of millions of U.S. retirement investors, I examine the dynamics of individual portfolios with respect to two types of wealth shocks: income growth and portfolio returns. Controlling for infrequent portfolio adjustment and ex-ante differences across individuals, positive and persistent shocks to income lead to an increase in the equity share of investor portfolios. Increases in financial wealth due to realized returns lead to a small decline in the equity share. The positive net effect of income growth and portfolio returns on equity shares is evidence of risk aversion that decreases in total wealth. Second, I structurally estimate a lifecycle consumption and portfolio choice model with portfolio adjustment frictions that targets these moments. The model matches the empirical findings when accounting for countercyclical tail risk in labor income and for significant non-homotheticity in risk preferences. The average elasticity of risk aversion with respect to permanent income is −0.15. Third, the model has important long-run implications for inequality. Decreasing risk aversion in wealth generates substantial dispersion in expected returns over the wealth distribution and concentrates equity in the hands of the wealthy, which doubles the wealth share of the top 1%. The model suggests that rising income inequality in the U.S. has led to a 16% decline in the equity premium over the past three decades.

∗I am very grateful to Jonathan Parker, Lawrence Schmidt, and Antoinette Schoar for their continuous guidance and support. I also thank Taha Choukhmane, Leonardo Elias, Eben Lazarus, Fangzhou Lu, Debbie Lucas, Jim Poterba, Duncan Simester, Adrien Verdelhan, Iván Werning, and seminar participants at the MIT finance seminar, MIT finance lunch, and MIT macro lunch for comments and suggestions. I thank an anonymous U.S. financial institution for use and explanations of their data. Data were obtained under a non-disclosure agreement. I thank the Macro Financial Modeling Initiative for dissertation support.
†MIT Sloan School of Management, email: meeuwis@mit.edu.
1Draft is pending final clearance by the data provider for release in the public domain.