# Research Reveals Why Some Stocks Keep Winning, While Others Keep Losing

**A new study suggests that investor psychology plays a big role in why stock prices show strong momentum – the tendency for prices to continue in the same direction, either rising or falling.**

While stock analysts and researchers have long known about stock momentum, there has been debate about what causes it, said Bing Han, co-author of the study and assistant professor of finance at Ohio State University's Fisher College of Business.

“We found that it is a type of psychological bias on the part of many investors that seems to drive momentum,” Han said. “Investors tend to hold on to their losing stocks too long and sell their winners too quickly. This triggers momentum.”

Han conducted the study with Mark Grinblatt of the University of California at Los Angeles. Their results appear in a recent issue of the Journal of Financial Economics.

The tendency to hold on to losing stocks and sell winners is called the disposition effect, Han said. If many investors fall prey to this type of bias, it will affect stock momentum.

What happens is that the stock price for a company may go down because of some bad news about the company. But many investors don't want to sell their stock at a loss, so they hold on, hoping the price will rise later. But if too many people hold on to their stocks, that means the stock price does not accurately reflect the bad news about the company.

This prompts some investors, noting that the stock is overvalued, to “short sell” the stock, betting that prices will fall. This cycle continues to push prices of the stock down, creating a momentum effect.

A similar situation occurs when a stock is rising because of good news for a company. Many investors may decide to sell the stock quickly, to capture the gains before prices fall. But if they sell quickly, the price may not rise to the level it should, based on the good news. This will prompt more investors to buy the stock, creating upward momentum in prices.

“The disposition effect plays a very important role in explaining this stock momentum,” Han said.

Most momentum investors measure momentum by comparing a stock price today to what it was at a point in the past, such as six months or a year ago. If the price is higher now, then the stock has upward momentum; if it is lower then the momentum is downward.

But if investors are swayed by the disposition effect, Han said the important issue would be to compare what the price is now to the price an investor paid

for it – whether it was three months ago, a year, or 10 years ago.

“There's nothing special about a stock price six months or a year ago. Investors want to make sure that the current price is high relative to what they paid for it,” Han said.

To test their theory, the researchers examined all shares traded on the New York and American stock exchanges between July 1962 and December 1996.

Han and Grinblatt developed a complex statistical model that allowed them to calculate the average price investors paid for each stock, and compare that to prices at later dates. In that way, they were able to see how the disposition effect was related to stock price momentum.

The results showed that their model was a better measure of momentum than other, simpler models.

“We now have a better idea than ever before about what is driving stock price momentum,” Han said.

Theoretically, with the information in this model, investors could measure price momentum more efficiently and earn more in the stock market, Han said.

Source: Ohio State University

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