

## Instructions [Task 1]

**Welcome!** You are participating in a decision-making experiment in which you can earn points which may be converted to real money. Participants completing the three tasks will be randomly chosen to get a gift card at Akademibokhandeln for a value equal to their total money payout until the budget of this experiment is exhausted. Apart from that, completing the tasks of the experiment is a requirement to earn the seminar points in the course.

In order to ensure the validity of the results of this experiment, cooperation is not allowed. Use the chat to post any questions you may have. If you fail to follow these rules you may be asked to leave the experiment without any compensation for your participation (this will also imply that you will obtain no seminar points). We expect and appreciate your cooperation today.

### THE EXPERIMENT

The experiment is divided into four parts: three choice tasks and a questionnaire. In each of the four parts, you will make choices which determine the number of points that you earn during the experiment. At the end of the experiment, the screen will display how many points you have earned. Lastly, you will be asked to complete a brief demographic survey.

A **practice round** is played **without rewards**, before playing a task for points. After the practice rounds, a short quiz is used to test your understanding of the task.

### TASK 1

You are asked to form an investment plan. For each possible scenario, you have to divide your budget (**Money**) into (i) an amount **S** which is invested in a stock whose price can either increase or decrease with a known probability, and (ii) an amount **C** in risk-free cash. You start with a budget of **Money**=100, but the budget can increase or decrease depending on your decision and the random price changes. But the sum of the amount in stocks and the amount in cash always equals the total budget: **S + C = Money**.

Your investment plan will look similar to the one in Figure 1.1. Please note that the numbers in Figure 1.1 are hypothetical and are not necessarily representative of the ones you will see during the actual task.

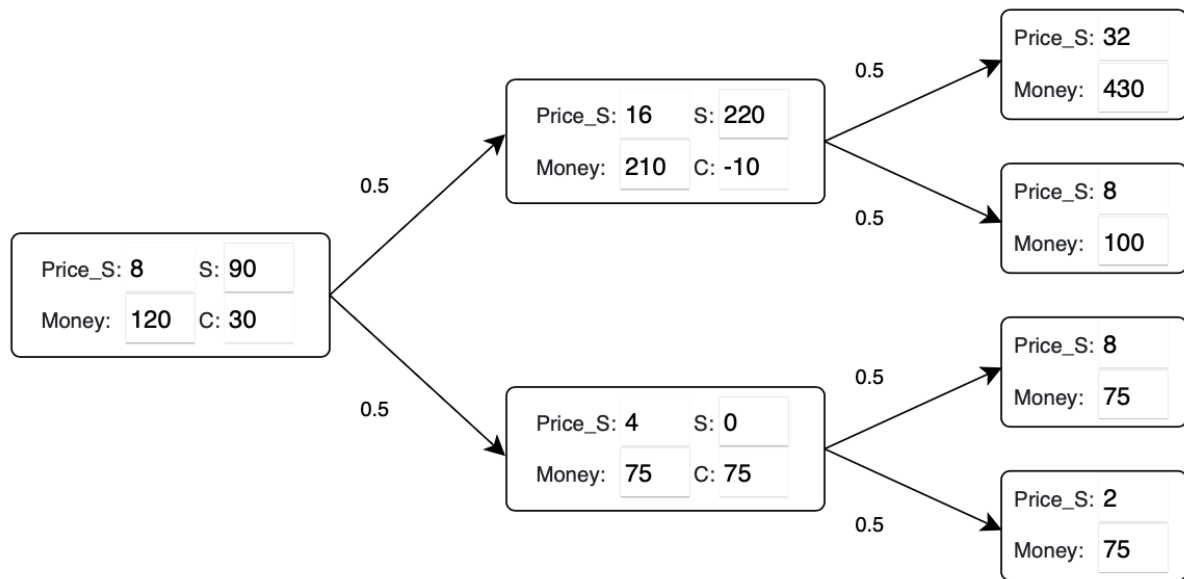


FIGURE 1.1

Figure 1.1 illustrates a simplified version of the game. The task in the figure has only two step and three decision boxes and leads to only 4 possible outcomes at the end of the task. In the first box, on the left side, you will make your first decision about how to divide your initial budget of **Money = 120** between **S** and **C**. Should you choose to allocate all your money to **C**, it would be equivalent to keeping your initial wealth constant, as there is no risk of loss and no possibility of gain.

In the **actual task**, you will play an extended versions with three steps, seven decision boxes and eight possible outcomes (instead of four). The rules are however exactly the same as in Figure 1.1.

Each decision box will display information about: 1) the stock price **Price\_S**, 2) your current money amount **Money**, 3) the money amount in stocks, **S** and 4) the amount of cash, **C**. The four terminal boxes show the final price **Price\_S**, and your final position **Money** in a given scenario. Each box is connected by arrows with the possible decision box for the next step. The decimal numbers above or below the arrows are probabilities of the stock price going up or down (for example, 0.5 means a probability of 50 percent or a fair coin flip). Each of the scenarios is equally likely to occur and will be randomly selected by the computer.

The initial price **Price\_S** is 8, which can either double or decrease by half with 50 percent probability. If the price increases, then you move to the upper box where the price is 16 and the money that you allocated stocks (**S**) doubles. If the price decreases, then you move to the lower box where the price is 4 and the money you allocated to stocks (**S**) is halved.

In either scenario, the cash amount **C** will remain the same. For example, if you chose **C=80**, then your cash money amount will still be 80 at the next box (unless you decide to change it yourself, of course), regardless of whether you moved up (because **Price\_S** went up) or down (because **Price\_S** went down).

Once you decide how much money to invest in stocks (**S**), the computer will automatically compute the cash amount as

$$\mathbf{C = Money - S}$$

The cash amount can become negative (**C<0**) if you enter an amount that is larger than your budget (**S>Money**). This means that you *borrow* a money amount of **C** and invest it in stocks. You can also enter a negative value for **S**, which means that you borrow an amount of stocks and invest it in cash. Professional investors call this *short selling*.

You can choose negative money amounts as long as your next-period money amount does not go below zero in any scenario. If this condition is violated, then the computer will not allow you to submit such plan and an error message will pop up on your screen.

Consider the following examples:

1. If your budget is 80, and you invest **S=40** in stocks and **C=40** in cash, then in the next period (i) if the price **Price\_S** goes up, you will own **S=80** in stocks and **C=40** in cash, a total of amount of  $80+40=120$ , or (ii) if the price **Price\_S** goes down, you will own **S=20** and **C=40**, a total of  $20+40=60$ .
2. If your budget is 80, and you invest **S=120** in stocks and **C=-40** in cash, then in the next period (i) if the price **Price\_S** goes up, you will own **S=240** in stocks and **C=-40** in cash, a total of amount of  $240-40=200$ , or (ii) if the price **Price\_S** goes down, you will own **S=60** and **C=-40**, a total of  $60-40=20$ .
3. If your budget is 80, and you invest **S=-40** in stocks and **C=120** in cash, then in the next period (i) if the price **Price\_S** goes up, you will own **S=-80** in stocks and **C=120** in cash, a total of amount of  $-80+120=40$ , or (ii) if the price **Price\_S** goes down, you will own **S=-20** and **C=120**, a total of  $-20+120=100$ .
4. If your budget is 80, and you chose **S=200** in stocks and **C=-120** in cash, then an error message will appear, because if the price **Price\_S** goes down

in the next period, you will own **S**=100 and **C**=-120, giving a *negative* total of  $100-120=-20$ , which is not allowed.

Once you have completed your plan, you can submit it by clicking on the “Next” button on your screen. The computer will generate a “fair coin flip” for every box to determine whether the stock price **Price\_S** increases or decreases. The random sequence of “fair coin flips” generated by the computer will determine your final outcome. Your final money amount, which is the amount of points you earn in this task, will be added to the points earned in the other tasks and it will thus contribute to the total amount of money you might take home.