

The Nature of High Risk Investing: Risky Business or Gambling?

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Table of Contents

| | |
|--|----|
| Table of Contents..... | ii |
| Abstract..... | iv |
| Candidate Declaration | v |
| Acknowledgements | vi |
| INTRODUCTION | 1 |
| References..... | 4 |
| LITERATURE REVIEW: PAPER 1: Arthur, Williams & Delfabbro (2016)..... | 6 |
| Introduction..... | 6 |
| Statement of Authorship..... | 7 |
| Conceptual Relationship between Gambling, Investing, and Speculation | 9 |
| Activities and Instruments..... | 10 |
| Time Frame | 11 |
| Level of Risk..... | 12 |
| Positive or Negative Expected Return..... | 12 |
| Role of Chance versus Skill..... | 13 |
| Asset Purchase | 14 |
| Stake..... | 15 |
| Definitive Event and Outcome | 15 |
| Macroeconomic Benefit..... | 15 |
| Summary | 16 |
| Empirical Relationship between Gambling, Investing, and Speculation..... | 18 |
| Cognitive, Motivational, and Personality Similarities..... | 18 |
| Overall Level of Gambling is Related to Overall Level of Speculation | 19 |
| Individual Speculator Involvement in Gambling..... | 20 |
| Overlap between Problem Gambling and Problematic Stock Trading..... | 21 |
| Discussion and Conclusions | 22 |
| Implications and Future Research | 24 |
| References..... | 26 |
| PAPER 2: Arthur, Delfabbro & Williams (2015)..... | 36 |
| Introduction..... | 36 |
| Statement of Authorship..... | 37 |
| Publication | 38 |
| PAPER 3: Arthur & Delfabbro (2016)..... | 59 |
| Introduction..... | 59 |
| Statement of Authorship..... | 60 |
| Publication..... | 61 |
| PAPER 4: Arthur, Delfabbro, Williams & Varjassy (submitted) | 73 |

| | |
|---|-----|
| Introduction | 73 |
| Statement of Authorship | 75 |
| Abstract..... | 77 |
| Introduction | 78 |
| The present study..... | 80 |
| Method..... | 81 |
| Location..... | 81 |
| Recruitment..... | 82 |
| Baseline Questionnaire..... | 82 |
| Trading Room Competition | 85 |
| Money Round | 88 |
| Results | 89 |
| Sample Demographics | 89 |
| Investment Behaviour, Motivation, and Knowledge..... | 89 |
| Gambling Behaviour and Correlates | 90 |
| Initial Portfolio Selection in the Trading Room Competition | 92 |
| Summary of Risky Portfolio Predictors..... | 96 |
| Investment Success in the Trading Room Competition..... | 98 |
| Summary of Predictors of Investment Success..... | 102 |
| Performance in the Money Round | 103 |
| Discussion | 103 |
| Risky Portfolio Selection..... | 103 |
| Investment Success..... | 105 |
| Limitations | 108 |
| References..... | 109 |
| SUMMARY, DISCUSSION AND CONCLUSIONS | 114 |
| Summary of the Four Papers | 114 |
| Discussion and Conclusions | 118 |
| General Limitations..... | 120 |
| Future Directions..... | 121 |
| References..... | 123 |
| Appendix A: Arthur, Williams & Delfabbro (2016)..... | 127 |
| Appendix B: Supplementary Materials for Paper 4 | 139 |
| Recruitment Poster..... | 139 |
| Baseline Questionnaire | 140 |
| Prospectus..... | 178 |
| News Releases | 182 |
| Follow-Up Questionnaire | 184 |

Abstract

This thesis seeks to understand the theoretical and empirical relationship between gambling and financial market speculation. More specifically, are there fundamental conceptual differences between engaging in traditional forms of gambling, such as sports betting and electronic gambling machines, and engaging in speculative activities on the financial markets such as day trading and penny stocks? And, regardless of whether conceptual differences exist, a) To what extent do traditional gamblers engage in financial market speculation and vice versa?, and b) What individual differences, if any, predict engagement in one but not the other?

In a series of four studies this thesis documents that gambling is conceptually distinct from investment, but that financial speculation is conceptually intermediate between gambling and investment. Consistent with the conceptual overlap between gambling and speculation, the studies within this thesis show there to be a strong empirical relationship at both the population level and individual level between these two activities.

In general, the large majority of speculators also appear to engage in traditional forms of gambling, particularly skill-based formats. An important reason for this overlap is that skill-based gambling and speculation are very similar to each other. Because of the similarity in their nature, they tend to attract similar types of people. A central feature of both gamblers and speculators is having a propensity for taking risk, and secondarily, having an excitement-seeking orientation. Speculators and skill-based gamblers also both share cognitive biases of overconfidence, a tendency to confirm rather than disconfirm beliefs, illusion of control, gravitation toward products with low participation costs and high potential returns, and being highly loss-averse.

Although the large majority of speculators are involved in gambling, only a minority of gamblers are involved in financial speculation. The likely reason for this difference is likely that most skill-based gamblers do not perceive themselves to have the level of knowledge, experience, or income needed for financial speculation. Consistent with this contention, age, educational attainment, and income are the demographic variables that most strongly discriminate between speculators and gamblers.

Candidate Declaration

I certify that this work contains no material which has been accepted for the award of any other degree or diploma in my name, in any university or other tertiary institution and, to the best of my knowledge and belief, contains no material previously published or written by another person, except where due reference has been made in the text. In addition, I certify that no part of this work will, in the future, be used in a submission in my name, for any other degree or diploma in any university or other tertiary institution without the prior approval of the University of Adelaide and where applicable, any partner institution responsible for the joint-award of this degree.

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