Abstract

Motivated by the recent evidence of investors’ preference for stocks with lottery-type payoffs documented on the U.S. stock markets, I investigate preferences for stocks that appear to be like lotteries in Europe. Across 14 markets, lottery-type stocks, characterized by high idiosyncratic skewness, high idiosyncratic volatility and low price, underperform and exhibit a "lottery premium". Furthermore, preferences for lottery-type stocks can help to explain the puzzling negative relation between past idiosyncratic volatility and returns, which does not persist after controlling for past extreme positive returns. Examining the relation between national revenues from gambling and "lottery premium" I find that countries featuring higher gambling revenues also exhibit a higher "lottery premium". Overall, the results indicate that lottery preferences might impact investment decisions and stock prices.

JEL Classification G11, G12

Keywords gambling, lottery-type stocks, idiosyncratic volatility, maximum returns

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