

National Economic Trends

Stockholding Is Still Highly Concentrated

The 1990s turned out to be an exceptionally good period for stock market investors. The Standard and Poor's 500 index, which measures the value of the largest 500 firms, reported increases eight years during that decade and climbed 15 percent per year on average. Many observers have noted that the stock market boom in the 1990s coincided with a surge in the number of households that owned stocks, either directly or indirectly—through mutual funds, retirement accounts and other managed assets. As shown in the accompanying chart, the stock market participation rate rose sharply from 32 percent in 1989 to 49 percent in 1998. Thus, the proposition that a large influx of new investors propelled the stock market in the 1990s is worth examining.

Economic theory suggests that if an increase in the number of shareholders spreads stock-market risk over a larger pool of investors, then the rate of return required to compensate shareholders for the risk they bear ought to fall—causing a one-time increase in stock prices. It is tempting, then, to argue that the increase in stock market participation played a significant role in the recent stock market boom. A close examination of the data shows, however, that most new shareholders own a relatively small amount of stocks, so that aggregate stockholdings remain highly concentrated in the hands of the wealthiest 10 percent of households. As shown in the accompanying chart, the share of stocks held by the richest 10 percent of U.S. households remained between 78 and 82 percent for the period 1989 to 1998. Hence, the economic argument discussed above does not apply because, even though the number of shareholders has increased, a relatively small pool of wealthy investors still bears most of the risk in the stock market.

Given that stocks have outperformed government bonds by a large margin on average, it is puzzling that a large fraction of U.S. households holds few or no stocks. In the current issue of the Federal Reserve Bank of St. Louis *Review*, I give a brief survey of possible explanations.¹ First, it is costly to collect and process information about stocks, and such information costs may be prohibitive for small investors. Second, a house is the most important asset held by the average household, and volatile housing prices pose a considerable risk, which could lead to conservative financial investing. Third, stock market returns are volatile in the short run and tend to be negative during business cycle downturns—just when workers face an increased risk of being unemployed. Thus, working people—who face considerable labor income risk and have a limited ability to borrow—often choose to put their savings into relatively safe assets instead of stocks.

Although information costs arguably have become less important due to the information technology revolution, patterns of home ownership and reliance on labor income help explain why stock ownership remains highly concentrated in the hands of a few wealthy households, despite the large increase in the number of shareholders in the last decade.

—Hui Guo

¹Guo, Hui. "A Simple Model of Limited Stock Market Participation." Federal Reserve Bank of St. Louis *Review*, V. 83, No. 3, May/June 2001.

