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## RESEARCH ELSEWHERE

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This issue of *The Journal of Psychology and Financial Markets* inaugurates a regular section, which has as its goals helping readers to keep current, and facilitating dialogue across the diverse disciplines contributing research to behavioral financial decision-making. Called “Research Elsewhere” this new feature consists of short descriptive abstracts of articles which are germane to the focus of JPFM, but which have been published elsewhere. Since there are over sixty journals which sporadically carry research relevant to JPFM readers, the summaries we present will be brief with the purpose of encouraging readers to acquire the full text of these important studies.

We welcome the assistance of readers in this new endeavor and invite you to notify the Editor about articles which you feel are of sufficient importance that they should be abstracted and brought to the attention of other JPFM readers. In addition to the obvious names are a number of journals, listed below, which, more often than most, contain research germane to the focus of the JPFM.

*Journal of Consumer Psychology*  
*Journal of Consumer Research*  
*Journal of Behavioral Decision Making*  
*Journal of Organizational Behavior and Human Decision Process*  
*Risk Analysis*  
*Journal of Economic Behavior and Organization*  
*Journal of Economic Psychology*  
*Journal of Risk and Uncertainty*  
*Journal of Socio Economics*  
*Accounting Organizations and Society*  
*Accounting Horizons*  
*Journal of Personality and Social Psychology*  
*Journal of Experimental Psychology*  
*Evolution and Human Behavior*  
*Memory and Cognition*  
*Alternative Perspectives on Finance and Accounting (Online)*

Robert A. Olsen  
Decision Research

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**Robert A. Olsen** is Professor Emeritus from California State University, Chico and a Research Fellow with Decision Research in Eugene, Oregon. He holds graduate degrees in Finance from the University of Oregon and the University of Massachusetts. Professor Olsen has business experience as a Financial Analyst and consulting experience with small business start-ups. Professor Olsen’s research interests are focused on Risk Perception and Behavioral Finance.

### Judging Risk and Return of Financial Assets

by Yoav Ganzach

*Organizational Behavior and Human Decision Processes*, Vol. 83, No. 2, November, 2000, pp. 353–370.

The author suggests that risk and return judgments are the result of different cognitive processes depending upon whether a financial asset is familiar or unfamiliar to the investor. In the case of familiar assets, perceived risk and return are the determinants, rather than the result, of a global preference. In particular, perceived risk and return are determined by actual values of risk and return, much in the model of standard financial theory. However, in the case of less well-known or unfamiliar assets, judgments of risk and return are based on a global preference toward assets of the type. Assets that are seen as less desirable are seen to be both more risky, have lower expected returns, and vice versa.

More generally, risk judgments and attractiveness judgments represent two related yet distinct concepts. The suggestion is made that stock analysts often appear to evaluate and choose among stocks based on global attitudes toward stocks rather than on the basis of their actual risks and returns.

Empirical results are derived from controlled experiments with graduate business students who have prior business experience.

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### How Do Investors Make Predictions? Insights From Analogical Reasoning Research

By Jennifer Gregan-Paxton and Jane Cote

*Journal of Behavioral Decision Making*, Vol. 13, No. 3, 2000, pp. 307–327.

Reasoning by analogy is a core cognitive process involved in judgment and decision making. In this empirical study, using data derived from controlled experiments involving experienced investors, the authors provide evidence that reasoning by analogy plays an important role in financial choice. More specifically, investors transfer existing knowledge via two different forms of analogical reasoning. Relational reasoning is based on structural correspondence between a novel company and a referent company. Literal similarity reasoning is based on surface (superficial) correspondence

between a novel company and a referent company. The authors find that investors make significant use of both types of analogical reasoning, but that relational reasoning seems to be used more often. Theory suggests that literal similarity reasoning should not be preferred. However, the authors note that in natural environments, structural and surface features are often highly correlated such that the easier and faster literal similarity reasoning might suffice. In contrast, in the newer and more artificial financial environment, the use of literal similarity reasoning can lead to poor decisions.

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### **The Instinctive Mind on Wall Street: Evolution and Investment Decision Making**

By Robert Olsen

*Journal of Investing*, Vol. 9, No. 4, 2000, pp. 47–54.

In a first of its kind survey article, the author brings together the results from a large number of empirical studies to show the role that human biological evolution appears to play in the investment decision process. In particular, the author presents evidence that herding, overconfidence, loss aversion, and heavy reliance on concrete, personal, and affective information appear to have evolutionary roots. More generally, the author argues that the new field of evolutionary psychology may be crucial to the constructions of new models to explain anomalous price behavior, trading patterns, and risk premiums in the security markets.

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### **The Relevance of GAAP-Based Information: A Case Study Exploring Some Uses and Limitations**

By Marinus Bouwman, Paul Frichkoff  
and Patricia Frichkoff

*Accounting Horizons*, Vol. 9, No. 4, 1995, pp. 22–47.

This empirical study focuses on the use of quantitative and qualitative information in the stock selection task. Using information obtained using verbal protocols from professional security analysts, the authors find that the type and weighting of information differs by task. In particular, GAAP (generally accepted accounting practices) based quantitative information primarily serves a screening function in quickly eliminating unattractive investment candidates. However, it plays a minor role when developing a case for an investment. This decision largely relies on qualitative information about the firm and individual industry segments. In general, the emphasis is on disaggregated, future oriented information when making a case for a particular investment.

Four types of activities can describe the security evaluation process: familiarizing, exploring, scanning, and reasoning. GAAP information was used about 70% of the time for familiarizing, about 55% for exploring and scanning, and 38% for reasoning. Also, financial statement information, most prominently income statement information, was used more extensively than ratio information in the familiarizing, exploring, and scanning stages. However, ratios were the primary type of GAAP information used in the reasoning stage of asset evaluation.

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### **Emotional Arousal as a Source of Bounded Rationality**

By Bruce E. Kaufman

*Journal of Economic Behavior and Organization*, Vol. 38, 1999, pp. 135–144.

Recent research in neuroscience and cognitive psychology emphasize the need for emotion in rational choice. In this conceptual paper, the author incorporates emotional arousal into Simon's concept of bounded rationality. Whereas Simon focused on human cognitive constraints such as limited computational ability and memory, Kaufman argues that bounded rationality can be caused by extreme emotional states. In particular, deficient levels of emotion reduce the quality of decisions just as extreme levels of emotion do. More importantly, Satisficing can be seen as a phenomenon of motivation. Once arousal reaches a certain satiation level, it no longer exerts a motivational pull, and the decision maker satisfices. The author cites numerous research studies to support his hypotheses.

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### **Capital Markets Research and Real World Complexity: The Emerging Challenge of Chaos Theory**

By T. Mouck

*Accounting Organization and Society*, Vol. 23, No. 2, 1998, pp. 189–215.

The author points out that economists have developed the unfortunate habit of forcing real world economic complexity into the neat world of Newtonian mechanics with the result that their models and predictions often yield results that are far from the mark. For example, in spite of enormous developmental effort, current financial models are able to explain only 20%–30% of stock price behavior.

Professor Mouck reviews the research at the Santa Fe Institute to recast the study of financial markets as a

complex adaptive non-linear system, in the manner of the approaches currently used in the biological sciences. The SFI program is multidisciplinary focusing on the behavior of simple people coping with a complex situation as opposed to the traditional frame of incredibly smart “rational” people making decisions in simple situations.

The SFI researchers suggest that real world dynamic processes cannot be adequately explored using traditional comparative static models, nor by repeated empirical experiments. Computer simulation, they feel, is currently the best tool to undertake such an exploration. Their results to date suggest that the current modern finance paradigm represents a very special case circumstance in a much more complex system of states and given this situation, we should not expect current financial models to have very much to say about the behavior of financial markets most of the time.

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**Contagious Speculation and a Cure for Cancer:  
A Nonevent That Made Stock Prices Soar**

By Gur Huberman and Tomer Regev

*The Journal of Finance*, Vol. 56, No. 1, February 2001,  
pp. 387–396.

This article describes how enthusiastic public attention induced a permanent rise in share prices of se-

lected Biotech companies even though no genuinely new information became available to the market. This article presents a clear counterpoint to market efficiency.

This “real life” event should be interesting to those studying the role of contagion and information transmission mechanisms in the stock market.

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**A Message From Psychologists to Economists:  
Mere Predictability Doesn’t Matter Like It  
Should (Without A Good Story Appended to It)**

By Robyn M. Dawes

*Journal of Economic Behavior and Organizations*,  
Vol. 39, 1999, pp. 29–40.

Much has been written recently of the evidence indicating that the human mind is modular and not under the control of a general problem solving mechanism. An implication of this research is that the framing of a decision is an important determinant of the information gathering and manipulation processes. Dawes argues that the problems decision makers appear to have in using probabilistic information results from situations where probabilistic information and concepts cannot readily be encapsulated in a clearly relevant causal story.

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