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RESEARCH ELSEWHERE

Robert A. Olsen

Do U.S. Stock Market Indexes Over- or Underreact?

by Oliver Schnusenberg and Jeff Madura

Journal of Financial Research, Vol. 24, No. 2, Summer 2001, pp. 179–204.

There now is a large literature devoted to the examination of over and under reaction in equity markets. Virtually all of the previous studies investigate the phenomena using observations of individual security prices. This study is unique because it examines the phenomena from a market-wide perspective thru the use of six U.S. stock market indexes. This alternative approach is important because it reduces the confounding influences of size, systematic risk, and bid/ask spreads, which are present in earlier studies of individual stock behaviors. The authors find evidence of short term (one day) and longer term (sixty day) under reaction for good news. That is, index moves on good news tend to continue to generate positive abnormal returns up to sixty days. Bad news also tends to create short term under reaction, but with a reversal to positive returns by sixty days. They attribute this set of behavior patterns to the uncertain information hypothesis, which states that investors overreact to negative news but under react to positive news.

How Distance, Language, and Culture Influence Stockholdings and Trades

by Mark Grinblatt and Matti Keloharju

The Journal of Finance, Vol. 55, No. 3, June 2001, pp. 1053–1073.

Home Bias refers to the well-documented tendency for investors to overweight domestic stocks in their investment portfolios. Economic explanations of this phenomenon involving transaction costs, capital flow barriers, exchange rates, etc. have not been very informative. In this unique data based study, the authors begin to investigate the Home Bias phenomena from a social/cultural perspective. Using a large and detailed data set from Scandinavia, they find that geographical distance, language, and culture influence not only individual, but to a lesser extent, institutional equity portfolios. Specifically, investors tend to invest disproportionate amounts of money in firms that are located nearby, report in their native tongue, and are managed by officers from their own culture. Experimental controls are included to insure that these results are not due to personal association with the firm, special knowledge of the firm, or purely informational effect due to a common language.

When Equal Chances = Good Chances: Verbal Probabilities and the Equiprobability Effect

by Karl Halvor Teigen

Journal of Organizational Behavior and Human Decision Processes, Vol. 82, February 2001, pp. 77–108.

Psychological research suggests that human decision makers use a "dual trace" decision process. Specifically, one decision process may be labeled rational or cognitive and involve the use of formal rules. The second process may be labeled experiential or affective and involve the use of intuition. Both systems can be in operation simultaneously, but to different degrees, depending upon the particulars of the decision situation. This laboratory study is interesting because it suggests that when verbal probability words, such as likely, are used the experiential mode becomes dominant. When numerical probability values are used, the rational decision mode becomes dominant. The relevance of this finding is that depending upon how a situation is "framed", a person's actual response to an uncertain choice situation can be very different.

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