
RESEARCH ELSEWHERE

Robert A. Olsen

Coveted or Overlooked: The Psychology of Bidding for Comparable Listings in Digital Auctions

by Uptal Dholakia and Kerry Soltysinski

Marketing Letters, Vol. 12, No. 3, 2001, pp. 225–237.

The causes and consequences of herding in securities markets have been topics of much interest recently. This unique empirical study of herding in digital auction markets offers insights that are relevant to securities markets. Using data obtained from E-Bay, the authors test a model that posits that herding should vary inversely with bid price and directly with the difficulty of evaluating the quality of the object bid upon. Empirical tests strongly support the author's hypotheses. The model presented suggests that the use of other's bidding behavior as cues (informational cascades) and the escalation of commitment, based on sunk cost effects, may vary well lead to herding, especially for stocks that are difficult to evaluate.

Advantages of Bias and Prejudice: An Exploration of Their Neurocognitive Templates

by A. Tobena, R. Dar and I. Marks

Neuroscience and Biobehavioral Reviews, Vol. 23, 1999, pp. 1047–1058.

This well referenced paper by a group of neuroscientists proposes that the well documented biases such as overconfidence, base rate neglect, illusory correlations, etc. stem from covert operation of neural modules that evolved over time to subserve adaptive

behavior. The authors cite research that illustrates the links between biases in cognitive tasks and the neural devices which mediate them. They suggest that the adaptive advantages of biases and prejudice include: speed in target detection, aiding rapid choice, creating stable categories for appraisal and motivating problem solving. In general, the authors posit that bias and prejudice result from the working of the same types of epigenetic rules that have been documented for language, cheater detection, etc.

Familiarity Breeds Investment

by Gur Huberman

The Review of Financial Studies, Vol. 14, No. 3, 2001, pp. 659–680.

The author begins with an extensive literature review demonstrating that investors tend to invest disproportionate amounts of money in stocks of familiar companies. Using stockholder data from the Regional Bell Operating Companies, Professor Huberman argues that the bias favoring the familiar does not appear to reflect any informational advantage, real or imagined. Instead, the preference for the familiar seems to reflect stockholder's tendency to be optimistic about and charitable toward what they feel affinity with. In general, stockholders tend to see more familiar investments as offering higher expected returns with less risk. Professor Huberman sees familiarity as a possible contributor to the well-documented "Home Country" bias of international investors.

Why the Low Returns to Beta and Other Forms of Risk?

by Edward M. Miller

The Journal of Portfolio Management, Winter 2001, pp. 40–55.

This conceptual paper presents an elegant argument that the very poor correlation between Beta and stock returns is due to the fact that larger divergence of opin-

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ion, caused by greater uncertainty, leads to overpricing of riskier stocks. More specifically, since stocks tend to be sold to the highest bidder, (those most optimistic), even where the market on average has unbiased expectations, the typical optimizing investor will be disappointed with his realized returns. The author suggests that if the standard CAPM assumption that investors have homogeneous expectations is eliminated, the theoretical SML will have a lower slope, consistent with the empirical SML. Professor Miller cites the high prices paid and the low returns earned on IPO's as an extreme example of the overpricing phenomena resulting from diversity of opinion about future firm performance.

Relating Individual Differences in Attitude Toward Ambiguity in Risky Choice

by Marco Lauriola and Irwin Levin

Journal of Behavioral Decision Making, Vol. 14, No. 2, 2001, pp. 107–122.

This experimental laboratory study using variants of Ellsberg's colored ball/urn technique suggests that risk aversion and ambiguity aversion are independent but related psychological constructs. In particular, while most subjects were ambiguity averse, there was usually a positive correlation between one's degree of ambiguity aversion and one's degree of risk aversion. The degree of positive correlation was greatest when the choice situation involved a possible loss as opposed to a possible gain. The correlation between ambiguity

aversion and risk aversion varied greatly between subjects. In addition, some subjects exhibited ambiguity seeking when the choice alternative involved a small probability of a success only. The authors also provide a brief review of relevant conceptual and empirical work indicating that ambiguity aversion is a stable personality trait and that it cannot be framed as a second order probability issue.

Judgment and Decision Making: The Dance of Affect and Reason

by Melissa Finucane, Ellen Peters and Paul Slovic

Research Paper No. 464, December 2000, Decision Research, Eugene, Oregon.

This review article examines the history, the role in decision-making and the implications of the "Affect Heuristic." The authors distinguish between affect, mood, and emotion and define the Affect Heuristic as positive or negative feeling attached to images which guide or direct judgments or decisions. A dual trace (cognitive/affective) decision model is discussed wherein affect acts as an orienting disposition to facilitate the decision process. Evidence is presented suggesting that affective influence is often unconscious and primary to cognition. Also, affective influence is very context dependent with a definite separate neurological origin. The authors indicate that some anomalous findings related to risk perception, attitude towards time, and inconsistent use of "facts" may be explained by individuals reliance on the Affect Heuristic.