
RESEARCH ELSEWHERE

Robert A. Olsen

Culture, Change, and Prediction

by Li-Jun Ji, Richard Nisbett and Yanjie Su

Psychological Science, Vol. 12, No. 6, 2001, pp. 450–456.

In this thought provoking experimental study using students, the authors indicate that culture influences the way in which change is perceived and expected to occur in the future. In particular, Chinese anticipate more change from an initial state than Americans and they also anticipate less continuity in the direction of change than Americans. Americans greater belief in the stability of conditions tends to create beliefs of greater predictability and control than is true of the Chinese. Also, Chinese tend to be less influenced by recent events when making forecasts than are Americans. These differences are seen to be function of the Oriental emphasis on the cyclical nature of existence as opposed to the linear Western tradition. The paper is pregnant with implications for stock market behavior.

Excessive Extrapolation and the Allocation of 401K Accounts to Company Stock

by Shlomo Benartzi

Journal of Finance, Vol. LVI, No. 5, October 2001, pp. 1747–1763.

This data-based study using market data and survey responses indicates that employees tend to invest larger than would be expected amounts of money in their employer's company stock. In general, this over investment is greater the better the historical performance of the stock even though there is no correlation between the past and future stock performance. In addition, most in-

vestors tend either not to pay much attention to the risk of such an investment practice, or they tend to see the risk of investing in the company as being less than that for the market as a whole. Also, there tends to be a negative correlation between company familiarity and the perceived risk of company investment. In general, employees tend to exhibit excessive positive extrapolation.

Risk as Feelings

by George Lowenstein, Elke Weber, Christopher Hsee and Ned Welch

Psychological Bulletin, Vol. 127, No. 2, 2001, pp. 267–286.

This conceptual paper, based on an extensive and comprehensive literature review, presents a model of risk perception and reaction that is both cognitive and emotional. In particular, the authors suggest that cognition and emotion are interrelated and react in a positive feedback process. In addition, the cognitive and emotional components of risk are cued by different personal and situational factors. For example, cognitive risk components tend to be related to probabilities and the desirability of possible outcomes whereas emotional risk components are related to vividness of outcomes, previous personal experience, proximity in time, etc. The authors suggest that the cognitive and emotional reactions to risk often diverge and when they do, the emotional or affective appraisal and reaction may well become dominant, even when it may not attain full conscious expression. This is one of the best papers to date offering a synthesis of the cognitive (analytical), and emotional (affective) components of risk.

Contrarian Strategies and Investor Expectations: The U.K. Evidence

by Mario Levis and Manolis Liodakis

Financial Analysts Journal, September/October 2001, pp. 43–55.

Using market data for 3,868 stocks traded on the London Stock Exchange from 1968 to 1997, the au-

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.

Requests for reprints should be sent to: Robert A. Olsen, Decision Research, 1201 Oak Street, Eugene, OR 97401. Email: rmolsen@qwest.net

thors suggest that stocks with high book to price ratios (value stocks) tend to be associated with biased analyst earnings forecasts. The biases do not appear to be the result of naïve extrapolation of the past, but instead result from insufficiently positive future earnings expectations, in general. As a result, positive earnings surprises have a much more positive effect on the prices of high book to price than low book to price stocks. Conversely, negative earnings surprises have a less deleterious effect on high book to price stocks than low book to price stocks. Consistent conclusions were reached with alternative measures of relative value such as earnings to price and cash flow to price.

The Effect of Information Strength and Weight on Behavior in Financial Markets

by Mark Nelson, Robert Bloomfield, Jeffrey Hales and Robert Libby

Organizational Behavior and Human Decision Processes, Vol. 86, No. 2, 2001, pp. 168–196.

This laboratory experimental market study revealed that extremity of information, as opposed to reliability of information, exerted the dominant influence on stock price. Investors with more extreme but less reliable information tended to bid as aggressively as investors with less extreme but more reliable information. Since the investors with the more extreme information also tended to be more extreme in their bids, the equilibrium market price was biased toward extreme values. More specifically, investors with extreme information tended to buy at too high a price and sell at too low a price. This study presents additional evidence suggesting that salience, rather than reliability, is very

often the dominant factor related to the influence of information on stock prices. In general, market participants lacked sufficient insight such that when presented with extreme but unreliable information, their level of confidence was equal to, or in some cases, greater than, others with more reliable information.

Money, Kisses, and Electric Shocks: On the Affective Psychology of Risk

by Yuval Rottenstreich and Christopher Hsee

Psychological Science, Vol. 12, No. 3, May 2001, pp. 185–190.

One important difference between Prospect Theory and the standard SEU model is that in Prospect Theory, outcome probabilities are replaced by decision weights. These weights trace an S shaped weighting function whereby very low probability outcomes are over weighted and very high probabilities are under weighted. It is usually assumed that marginal diminishing sensitivity is the cause of the S shape and that therefore the value and the weighting functions are independent. In this experimentally based paper, the authors demonstrate that the weighting function can be related to the value function thru affective influence. In particular, they find that the weighting function becomes more S shaped the more affect rich the possible outcome. For example, for favorable outcomes of high emotional intensity, low probability outcomes are more heavily over weighted than when the emotional intensity is less. In general, the authors propose an affective deconstruction of the weighting function wherein the large jumps at the end of the function reflect emotional reaction to possible outcomes.

