
RESEARCH ELSEWHERE

Robert A. Olsen

How Important is Past Analyst Forecast Accuracy?

by Lawrence D. Brown

Financial Analysts Journal, Nov./Dec., 2001, pp. 44–49.

Extensive evidence indicates that, in general, security analysts' earnings forecasts are surprisingly inaccurate. Therefore this researcher investigates whether it is possible to identify in advance, using information other than the accuracy of past forecasts, analysts with superior forecasting ability. Specifically, he tests models incorporating variables such as years of analyst experience, number of companies followed, the complexity of the industries and companies followed, etc. Based on approximately 123,000 annual and quarterly forecasts over the period 1986–1998, Brown finds that practitioners focus on past forecast accuracy is not unjustified. At the margin, more complex analyst selection models, which include variables other than past accuracy, do not appear to be worth the effort and cost.

Neither an Angel nor an Ant: Emotion as An Aid to Bounded Rationality

by Yaniv Hanoch

Journal of Economic Psychology, Vol. 23, No 1, 2002, pp. 1–25.

In this conceptual essay the author suggests that emotions augment rational thinking in two essential ways. First, they restrict the range of options contemplated and evaluated, as must be done, if a decision is ever to be made. Second, they focus the decision makers' attention on parameters and informational aspects that are usually most consequential to adaptation and survival. More generally, the author views emotion as a device that allows bounded rationality to become functional. The author reviews a very wide of research from many fields, including Psychology, Economics,

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.

Neuroscience, Marketing, and Decision Science, as he develops his thesis.

Taking Stock of Naturalistic Decision Making: A Focus Article

by R. Lipshitz, G. Klein, J. Orasanu and E. Salas

Journal of Behavioral Decision Making, Vol. 14, 2001, pp. 331–352.

This comprehensive review article compares Naturalistic Decision theory with Classical Decision theory, Behavioral Decision theory, and Organizational Decision theory. The author begins by emphasizing that Naturalistic Decision theory is unique because it attempts to understand how experts make decisions in real world contexts that are meaningful and familiar. More specifically, Naturalistic Decision theory studies decision making where problems are ill structured, the environment is dynamic and unstable, there exist competing goals, time constraints, and the stakes are usually high. Typical examples include military field command, firefighting, and possibly, securities trading. The authors suggest that Naturalistic Decision Making tends to look upon the decision process as one that is ecologically adaptive and not based on mechanical calculation and information intensiveness. In Naturalistic Decision situations the key to a good outcome primarily lies in correctly sizing up the situation and utilizing mental models and templates to efficiently simulate possible scenarios and decision outcomes. Considerable emphasis is given to viewing a decision as a single step in a whole series of decisions necessary to achieve a desirable outcome. Just as Behavioral Decision theory has shown that real world decision makers don't rely on Classical techniques, even where possible, Naturalistic Decision theory shows how expert decision makers can make good decisions when classical decision techniques cannot be applied.

The Problem of External Validity in Experimental Economics

by Francesco Guala

Social Science Information, Vol. 38, No. 4, 1999, pp. 555–573.

In this article, external validity refers to the conditions for justifiable extrapolation from an experimental set-up to a real market setting. Using the well known “preference reversal” phenomena as an example, the author argues that few theories in economics can stand up to the unconditional standard of cause and effect determination associated with theoretical sciences, such as Physics. The best that can be done is to describe some relationship that holds only when certain “background conditions” hold, in a limited domain of application.

He goes on to suggest that experimental economic results can only be generalized when a target system (market) is well defined, stable, and not very relationally complex. He suggests that all too often, experimental economists eliminate or alter the very background conditions that are key to the appearance of the real market phenomena, in a vain attempt to meet the classical condition of relational unconditionality.

Is There A Lottery Premium In the Stock Market?

by Thomas Downs and Quan Wen

Journal of Portfolio Management, Fall 2001, pp. 112–119.

In this empirically based study, using stock market data from 1963 to 1999, the authors find that low priced stocks tend to sell at a “lottery premium”, which results in lower risk adjusted (CAPM) returns. The authors suggest that investors in low priced stocks appear to make choices based on “hope”, because low priced stocks tend to exhibit relatively more extreme positive price fluctuations. In the terminology of Psychologist Lola Lopes, low priced stock investors are seen to be more “achievement” oriented than “risk” oriented. The authors do not pay much attention to other possible explanations for this premium effect, such as loss aversion, but the article does provide food for thought.

Effects of Outcome and Probabilistic Ambiguity on Managerial Choice

by Joanna L. Y. Ho, L. Robin Keller and Pamela Keltyha

Journal of Risk and Uncertainty, Vol.24, No 1., 2002, pp. 47–74.

Previous studies have shown that, in general, decision makers are averse to probabilistic ambiguity (uncertainty about the distributions of stated outcomes) in a gain frame but accepting of ambiguity in a loss frame. In addition, it has been well demonstrated that ambiguity aversion is independent of risk aversion (distributions of returns are known with certainty). Because evidence indicates that a majority of business decision makers tend not to pay a great deal of attention to probabilities, but more attention to the range of possible returns, the authors focus on how ambiguity about ranges of known returns influence decision choice. Their experimental results, using MBA students with management experience as subjects, indicate that decision makers are again ambiguity averse when things are going well (gain frame) and ambiguity selecting when outcomes are below target (loss frame). Their results also confirm previous findings for situations involving probabilistic ambiguity.

The Socio-economic Dynamics of Speculative Markets: Interacting Agents, Chaos, and the Fat Tails of Return Distributions

by Thomas Lux

Journal of Economic Behavior and Organization, Vol. 33, 1998, pp. 143–165.

This paper is important for two reasons. First, it is one of the seminal studies to demonstrate the value of agent-based simulation for the understanding of such market dynamics as bubbles and crashes. Second, it is unique in that it does not just assume the existence of fundamental and noise traders, but that traders often switch strategies, based upon the anticipated payoff of the available investment strategies. When simulating the effects of a reasonable set of assumptions about trigger processes in the switching process, the author finds that the simulated results quite closely mirror price and trading behavior in real stock markets. In particular, return distributions tend to have fat tails and to be leptokurtic. Bubbles and crashes occur as traders switch from fundamental strategies to contagion based and trend following strategies during periods of more rapidly rising and falling prices. He suggests that even if real market events occur in a fashion that would otherwise lead to normal return distributions, strategy switching is most likely to transform returns to a heavy tailed distribution.

Copyright of Journal of Psychology & Financial Markets is the property of Lawrence Erlbaum Associates and its content may not be copied or emailed to multiple sites or posted to a listserv without the copyright holder's express written permission. However, users may print, download, or email articles for individual use.