
RESEARCH ELSEWHERE

Robert A. Olsen

Neuronal Substrates for Choice Under Ambiguity, Risk, Gains, and Losses

by Kip Smith, John Dickaut, Kevin McCabe and Jose V. Pardo

Management Science, Vol. 48, June 2002, pp. 711–718.

Most Economists and many Decision Theorists have either assumed, or required, the independence of pay-offs and probabilities in risky choice. In addition, some cognitive researchers have more recently hypothesized the existence of a dual decision process involving the interaction of two separate but connected mental decision systems. One system is analytical in nature, while the other is more intuitive and affectively influenced. This important paper, reporting results based on the use of the latest brain imaging techniques, provides evidence for a dual decision process, while casting doubt on the appropriateness of the independence assumption. In particular, this brain imaging study of risky choice, uncovers evidence of interaction between two dissociable choice systems working in tandem. Specifically, two disparate choice systems with sensitivity to loss appear to exist. There is a neocortical dorsomedial system related to the processing of risky gambles and a more primitive ventromedial system related to the processing of feelings of ambiguity associated with potential gains and losses. The authors note that the simultaneous operation of these separate systems may easily result in interactive effects between probabilities and payoffs in risky choice situations.

Choice Preferences Without Inferences: Subconscious Priming of Risk Attitudes

by Hans Peter Erb, Antoine Bioy and Denis Hilton

Journal of Behavioral Decision Making, Vol. 15, 2002, pp. 251–262.

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.

The authors state that “most research on choice assumes that decisions are the result of conscious cognitive processes whereby information is processed and transformed into judgments and decisions by explicitly using inference rules”. This is in spite of substantial counterevidence for the Affective Primacy Hypothesis. The Affective Primacy Hypothesis holds that people's preferences and choices are often influenced by factors of which they are not conscious. This experimental study demonstrates that future risky choices can be influenced by unconscious affective feelings related to the completion of an unrelated previous task. More importantly, this study suggests that risk preferences are not as stable as is usually assumed and that they might be easily influenced by extraneous circumstances.

The authors demonstrate that the risk priming effect can be somewhat controlled thru the provision of appropriate information and warnings. However, over correction is often the result.

Time Dependent Gambling: Odds Now, Money Later

by Michael Sagristano, Yaacov Trope and Nira Liberman

Journal of Experimental Psychology, General, Vol. 131, 2002, pp. 364–376.

This experimental study, based on Construal Level Theory, suggests that decision makers place greater weight on outcomes as opposed to probabilities as the date of the payoff becomes more distant. Thus low probability, high payoff gambles are usually more attractive in the distant future, whereas high probability low payoff gambles may be more attractive in the near future. Construal Theory argues that temporal distance alters people's responses to future events by changing the way in which people mentally represent the events. According to CLT, desirability (outcome) is a higher-level feature (Construal) of an action than is feasibility (probability). Because temporal distance reduces the influence of lower-level Construals, more than higher-level Construals, probabilities receive relatively lower weight than outcomes as time to occurrence increases. The authors contrast and compare their model of out-

come/probability weight- shifting with alternative explanations. This article is very relevant to the ongoing debate over the "rationality" of investors' belief in "time diversification".

Time Discounting and Time Preference: A Critical Review

by Shane Frederick, George Lowenstein and Ted O'Donoghue

Journal of Economic Literature, Vol. XL., June 2002, pp. 351-401.

This scholarly article contains an extensive review of the alternative models and tests of the central economic principle of time discounting as an explanation of inter temporal economic choice. The authors begin with a history of the time preference concept and then proceed to discuss the many alternative models and anomalies. The authors conclude that this mainstay of inter temporal economic thought has little empirical support and that it should be gracefully retired. As a replacement, the authors suggest a return to earlier economic thinking which advocated the investigation of multiple psychological motives for inter temporal choice instead of the operation of some time discounting process. They suggest that a continued search for the "correct" discount rate is an exercise in "dis-utility."

UK Brokers' Characteristics: Does Size Matter

by Simon Hussain

Accounting and Business Research, Vol. 32, 2002, pp. 153-170.

This very well done empirical study uses UK data to investigate whether analysts in large investment firms generate earnings forecasts that are more accurate than those of analysts in smaller investment firms. In particular, large firm analysts might be expected to create more accurate earnings forecasts given their larger internal resources and superior access to subject firm personnel and financial data. Consistent with this hypothesis, and similar to findings for U. S. firms, analysts in large UK firms are found to generate more accurate earnings forecasts, especially for horizons of one year or less. In addition, where earnings changes are negative, large firm analyst forecast errors are relatively smaller than those of smaller firm analysts. The authors suggest that this may be due to a lesser need for large firms to issue favorably biased forecasts to main-

tain client business and executive contacts. Evidence is also reported showing that forecast error size is industry related, with larger forecasting errors for extractive and industrial firms and smaller forecasting errors for consumer goods and service industries.

Smart Money and Small Funds

by Julia Sawicki and Frank Finn

Journal of Business Finance and Accounting, Vol. 29, 2002, pp. 825-846.

Consistent with previous findings for U S. mutual funds, the authors report that small Australian mutual funds comprise a disproportionate number of superior performers. In addition these small funds tend to attract new funds at a greater relative rate than large funds, which have exhibited similar superior performance. In conclusion, the authors note that the "smart money" does seem to follow the small funds, wherein it is generally rewarded with superior future returns, *ceteris paribus*. However, a successful strategy of "betting on winners" applies primarily to investment in small funds. Young funds also exhibit post success funds flow patterns similar to small funds. Nevertheless, small funds offer the best chance of continuing superior returns. The authors discuss the relevance and implications of their findings for prior and future research.

The Mismeasurement of Risk

by Mark Kritzman and Don Rich

Financial Analysts Journal, May/June, 2002, pp. 91-99.

In this conceptual paper, the authors argue that investment risk should be measured by exposure to loss over the entire investment horizon, and not just at the anticipated horizon date. Given this focus, the authors derive two new statistical measures of risk, "within horizon probability of loss" and "continuous value at risk." The derivation of these new metrics reveals that the probability of loss within the investment horizon must always exceed the probability of loss at the horizon and that the probability rises as the horizon date lengthens. Thus, this paper presents a new challenge to those who argue that risk diminishes as the investment horizon lengthens (the essence of the time diversification debate). The second new risk measure, "Continuous value at risk," identifies the worst possible outcome, at a chosen probability, from inception until any time within the investment horizon.

