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RESEARCH ELSEWHERE

Robert A. Olsen

Temporal Construal

by Taacov Trope and Nira Liberman

Psychological Review, Vol. 110, 2003, pp. 403–421.

This extensive review article discusses the origin, nature and implications of Construal Theory for decision making. Construal Theory proposes that temporal distance changes decision makers' responses to future events by altering the way in which they mentally represent near and far future events. Specifically, according to Construal Theory, near term future events are perceived in terms of concrete and incidental details, whereas far term future events are framed in a more abstract and condensed fashion. This being the case, the direction and intensity of a response to an approaching event can change with the passage of time even though the essential features of the decision situation have not been altered. In addition, the authors demonstrate how Construal Theory can parsimoniously explain other distance dimension attitudes and behaviors, such as those associated with spatial distance, social distance, and past versus future events.

Time Discounting has been the principal theory used to explain most time related decision effects in Economics. However the theory appears to be incomplete in that patchwork modifications have been necessary to account for time related decision inconsistencies and contradictions. In particular, model modifications based on affect, conflict and outcome magnitude have been suggested. The authors discuss how these influences fit more naturally within Construal Theory, suggesting that time discounting itself may be subsumed within Construal Theory.

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The Predictive Power of Zero Intelligence in Financial Markets

By J. Doyne Farmer, Paolo Patelli, and Ilija Zovko

Santa Fe Institute Working Paper, Sept. 9, 2003, 22 pages. Available online.

This simulation based study provides stunning evidence for the importance of market structure as a determinant of aggregate stock market behavior. More specifically, it suggests that the price formation mechanism, rather than the strategic behavior of investors, may have the more profound influence on aggregate market behavior. This study thus provides additional evidence for the potential value of the "micro market structure" research, which is becoming prominent in the academic financial literature.

The authors of this paper constructed a simple model of market structure assuming zero intelligence on the part of investors. Investors were assumed to place standard market and limit orders, which were then traded in a continuous double auction. The model simulation results were tested using data from the London Stock Exchange. Overall, the model was able to explain 96% of the bid ask spreads across stocks and 76% of the price diffusion rate among stocks. While the authors do not suggest that real investors are unintelligent, they believe that studies such as this can provide benchmarks to identify strategy based investor influences on market behavior. Researchers at the Santa Fe Institute have been at the forefront of research investigating stock markets as complex adaptive systems. This study continues that research thread.

Consumer Perceptions of Financial Risk

By Stephen Diacon and Christine Ennew

The Geneva Papers on Risk and Insurance, Vol. 26, No. 3, July, 2001, 389–409.

This empirical research uses Slovic's psychometric risk paradigm to identify primary financial risk attributes perceived by a sample of British investors. Specifically, surveys were used to gather investors' perceptions about 27 risk related investment characteristics for 20 different investment products. Factor analyzed