
RESEARCH ELSEWHERE

Robert A. Olsen

Narcissism, Confidence, and Risk Attitude

by W. Keith Campbell, Adam Goodie, Joshua Foster

Journal of Behavioral Decision Making, Vol. 17,
2004, pp. 297–311.

This laboratory study used multiple tasks to investigate the influence of normal differences in narcissism on decision maker confidence and performance. Narcissism was defined as a social construct having two key elements: a positive, inflated and agentic view of the self; and a self-regulatory strategy to maintain and enhance a positive self image. Narcissism was measured with the validated NPI index. Test results revealed that more narcissistic individuals tended to be more overconfident on a choice calibration task and did more poorly, due to overconfidence, on a betting task. In addition, it was found that more narcissistic individuals estimated their performance less on how they actually did perform and more on how they expected that they would perform. The authors conclude that narcissists' decisions tend to be undermined by their short-term interest in maintaining an inflated self-image and that greater normal narcissism tends to be associated with greater risk taking.

Are Professional Traders Too Slow To Realize Their Losses?

by Ryan Garvey and Anthony Murphy

Financial Analysts Journal, Vol. 60, No.4, July/August, 2004, pp. 35–43.

This study appears to be the first to test a group of professional U.S. stock traders for evidence of the “disposition effect”. The “disposition effect” is the tendency of traders to hold on to losing positions too long and sell out winning positions too soon. Previous research has indi-

cated a disposition effect for non-professional investors. Using data from 15 traders covering approximately 96,000 NASDAQ stock transactions, the authors found evidence of the “disposition effect”. In particular, losing roundtrips tended to be held about 60% longer than winning round trips and greater profits could have been obtained by holding winning round trips longer and disposing of losing round trips faster. The average holding period across traders and trades was 197 seconds. Overall, traders were profitable because they made more winning than losing trades. Traders often attempted minimized loss exposure by trading fewer shares, trading low priced stocks, and trading during times of low market activity. While the authors did not investigate the origin of the “disposition effect” among professional traders, they suggest that feelings of comradeship and competition are likely to encourage behaviors enhancing pride and avoiding regret.

Decisions from Experience and the Effect of Rare Events in Risky Choice

by Ralph Hertwig, Greg Brown, Elke Weber
and Ido Erev

Psychological Science, Vol.15, No.8, 2004, pp.
534–539.

This laboratory study was designed to investigate whether the impact of rare events was a function how knowledge of the rare event was obtained. More specifically, it is known that individuals make decisions as if they overweight the probability of rare events when information is obtained from descriptions of prior outcomes. This study investigates the probability estimation process when information is based on the subject's prior personal experience. The authors find that contrary to results from estimates based on description, subjects tend to underweight estimates of the probability of future rare events when information is based on prior personal experience. Additional empirical analysis leads the authors to conclude that the underweighting of rare events in the “experience condition” is not only because decision makers have not encountered them, or have encountered them less often than expected, but also because they have not encountered them recently (a “recency effect”).

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Believing One's Own Press: The Causes and Consequences of CEO Celebrity

by Mathew Hayward, Violina Rindova and Timothy Pollock

Strategic Management Journal, Vol. 25, 2004, pp. 637–653.

This conceptual article presents a model explaining why journalists tend to over attribute CEO actions to volition, and how this leads to CEO overconfidence, hubris and a tendency to maintain previous patterns of behavior. The authors suggest that celebrity status (i.e. Welch at G.E.) is encouraged because journalists' work environments cause them to magnify fundamental attribution error by over-attributing behavior to the CEO's dispositional qualities. In particular, journalists generally operate under severe time and informational constraints and must present their ideas in a fashion that is simple and easy for the readership to comprehend. Dispositional accounts appeal to readers because they use the same causal structure that people adopt in interpreting actions and events in their daily lives. CEO's behavior is influenced by these dispositional perceptions because individuals generally rely on the perceptions of others to infer their own attitudes and beliefs and because CEOs are in a position to use celebrity status to increase their personal rewards. The net result of this chain of events is that CEOs become victims of their own celerity and become overconfident about the degree to which firm behavior is actually under their control. This leads to behaviors such as paying excessive premiums for acquisitions, extensive entry into new markets, the development of riskier products, and an escalation of commitment to a previous course of action. Since it is well known that investors place great weight on perceptions of management disposition and ability, celebrity status should have significant influence on stock prices.

Angry Men and Disgusted Women: An Evolutionary Approach to the Influence of Emotions on Risk Taking

by Daniel Fessler, Elizabeth Pillsworth and Thomas Flamson

Organizational Behavior and Human Decision Processes, Vol. 95, 2004, pp. 107–123.

This laboratory study used monetary gambles to investigate the influence of anger and disgust on risk taking. After reviewing evolutionary literature dealing with biological adaptation, the authors hypothesize that anger and disgust should have opposite emotional influences on risk taking. More specifically, anger should enhance risk taking since anger functions to deter aggression. Alternatively, disgust should reduce risk taking

since disgust normally functions to ward off contamination. In addition, the authors hypothesize that gender should play a role in moderating the effects of anger and disgust on risk taking. In particular they suggest that, given the evolutionary roles of men and women, that men should have a more pronounced risk seeking response to anger while women should have a more pronounced risk avoidance response to disgust. After inducing anger the authors find that men are more willing to undertake more and riskier gambles than women. Likewise, after inducing disgust, women are much less willing than men to undertake risky gambles. The authors conclude that risk research should not ignore the "hard wired" motivating responses of emotion.

Perspective Taking as Egocentric Anchoring and Adjustment

by Nicholas Epley, Leaf Van Boven, Boaz Keysar and Thomas Gilovich

Journal of Personality and Social Psychology, Vol. 87, No. 3, 2004, 327–339.

It is well known that individuals make choices, forecasts and decisions using information based upon the opinions of others. This experimental study investigates the manner in which a particular decision maker incorporates the opinions of others when forming their own opinion. In a series of experiments, the authors find that people appear to use an anchoring and adjustment process when incorporating the opinions of others. That is, people begin with their own opinion as the anchor and then sequentially adjust their belief towards that of others. They find that the adjustment is usually insufficient such that people terminate the process believing that others have an opinion more similar to their own than is actually the case (positive egocentric bias). Also, the degree adjustment is more insufficient as time pressure increases and the decision situation becomes more complex. Economic incentives appear to reduce, but not eliminate, egocentric bias. In concluding, the authors contend that individuals anchor on their own opinion because it is the most available and they cease the adjustment process when it appears that an acceptable (workable) solution has been reached.

Neural Evidence That Vivid Imagining Can Lead to False Remembering

by Brian Gonsalves, Paul Reber, Darren Gitleman, Todd Parrish, M. Mesulam, Ken Paller

Psychological Science, Vol.15, No.10, 2004, pp. 655–659.

This neuroscience study is interesting because it suggests that false memories may be a direct function of the level of intensity with which an individual is made familiar with a potential, but not experienced situation. In this study the authors monitored brain activity using MRI technology during the presentation of words and photographs. They found that engagement of visual imagery often leads to a greater false remembering of something that was only imagined. These results may have important implications for the manner in which investors respond to information about prior events that were not personally experienced. For example, might investors overestimate the potential of a stock market crash after seeing a movie about the crash of Wall Street in 1929? More generally it raises questions about the relationship between the vividness of an event and estimates of probability.

The Adaptive Market Hypothesis: Market Efficiency from an Evolutionary Perspective

by Andrew W. Lo

Journal of Portfolio Management, 30th Anniversary Issue, 2004, pp. 15–29.

This largely conceptual article identifies some of the key psychological and sociological ideas that

need to be included in any new theory of financial markets. The author envisions a new theory of financial markets grounded in evolutionary biology and psychology and called the “Adaptive Market Theory (AMT)”. The author correctly notes that many of the so called “anomalies” associated with the EMT don’t originate from inappropriate decision behavior in the absolute. Instead they reflect maladaptive applications of natural heuristics that work just fine in the old non- technical world in which humans have evolved. In addition, the author cites important new research indicating that emotion is indispensable for good decision making and not an obstacle to be banished as rational models usually suggest. The most important conclusion drawn by the author is that Herbert Simon was correct when he said that humans don’t have either the ability, desire or need to optimize. They only need to act in an adaptive fashion that allows for survival. This being the case, financial markets should be expected to exhibit behavior that is dynamically consistent with partial individual and institutional adaptation to a constantly changing biosocial scene. Thus we should expect that the risk/return trade off will vary over time, EMT type arbitrage opportunities will exist, and the success of alternative investment strategies will wax and wane. In fairness, it should be noted that an evolutionary based financial market theory has also been suggested by Gigerenzer, Olsen, and others.

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