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RESEARCH ELSEWHERE

Robert A. Olsen

"e" Information: A Clinical Study of Investor Discussion and Sentiment

By Sanjiv Das, Asis Martinez-Jerez and Peter Tufano

Financial Management, Vol. 34, No. 3, 2005, pp. 103–137.

This unique study utilizes a clinical methodology to examine investor behavior related to "online" stock message board posting activity. Specifically, the authors summarize "chat room" conversations and recommendations for four stocks listed on the major internet stock message boards. The database includes approximately 103,000 postings from 12,000 posters for a seven month period.

Contrary to conventional wisdom, stock message boards do not appear to be "rumor mills' promulgating incorrect and misleading information. In contrast, the data suggest that:

1. Although the Boards are not sources of inside information, they appear to play a significant role in rapidly disseminating "breaking" public information. Discussion of recent news items turns to analysis within a few hours after the initial posting of a news item and there is significant persistence in posting volume.
2. There is a positive relation between the number of postings, trading volume and poor security performance. More specifically, posting volume rises with negative stock performance, which itself is positively correlated with greater dispersion of opinion. Loss aversion shows clearly in posting discussions.
3. There was no evidence that stock returns were significantly influenced by posting volume or sentiment. On the contrary, it appeared that posting sentiment was driven by previous market return and trading volume and that sentiment tended to change slowly.
4. On line stock chat rooms appear to have value to posters in that they provide a vehicle for information exchange and a place for like-minded discussion. As might be expected, posting volume is skewed, as a small number of posters contribute a disproportionately large percentage of the messages.

Analysts' Weighting of Private and Public Information

By Qi Chen and Wei Jiang

Review of Financial Studies, Vol. 19, No. 1, 2006, pp. 319–355.

This empirical study investigates the weighting of public and private information in the earnings forecasts of "sell side" analysts. The sample consists of over 1.3 million forecasts by 5306 analysts, relative to 3195 firms, for 1985 to 2001.

The principle conclusion is that, on average, analysts tend to overweight information which they believe is "private' to them. However, there is an asymmetry to this behavior. In particular, analysts tend to overweight private information when their forecast is more favorable than the consensus forecast but underweight private information when their forecast is less favorable than the consensus forecast. Investigation of

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this pattern suggests that it is not caused by analyst overconfidence or an attribution bias. Instead it appears to be caused by an incentive structure that leads to intentional misweighting. Specifically, analysts are more likely to overweight private information to a greater degree when they cover highly traded stocks and when they have high perceived ability. Over weighting private information in such cases generates greater forecast deviations from the consensus and attracts investor interest. Investor interest translates to more trades and higher commissions. In short, misweighting is more a function of financial incentives than cognitive bias.

On Making the Right Choice: The Deliberation-Without-Attention Effect

By Ap Dijksterhuis, Maarten Bos, Loran Nordgren, Rick van Baaren

Science, Vol. 311, No. 5763, 2006, 1005–1007.

Using a series of laboratory experiments, the authors demonstrate that better decisions in complex situations can often be made with less conscious thought. That is, contrary to conventional wisdom, they suggest that conscious thought can lead to choices that are in hindsight less desirable than those made more "affectively" when decisions are complicated by alternatives with many attributes. The authors attribute this superiority of affective choice to the fact that rule based conscious thought is subject to low information capacity for physiological reasons. Alternatively, because "affective thought" is more pattern focused, it can often integrate larger amounts of information. They suggest that, while it is in general true that conscious thought leads to better a decision, that after a certain level of decision complexity is reached the quality of conscious choice falls below that of affective choice. The tests of the author's theory involve choices among common consumer goods. However, the theory is readily applicable to financial decisions.

The Endowment Effect: Rose-Tinted and Dark-Tinted Glasses

By Dhannanjay Nayakankuppam and Himanshu Mishra

Journal of Consumer Research, Vol. 32, December, 2005, pp. 390–395.

This experimental study tests a new hypothesis about the source of the Endowment Effect. The Endowment Effect involves behavior whereby subjects often demand more in compensation to give up an owned item than they would be willing to pay to acquire an identical item. In this study the authors find that the Endowment Effect is caused by buyers and sellers focusing on different item attributes. The usual explanation given for the Endowment Effect is that selling is perceived as incurring a loss and losses have greater hedonic value than equivalent gains from purchase.

In a series of three experiments, perceived positive and negative attributes of an item being traded were carefully monitored and measured. The results of the experiments suggested that sellers, in comparison to buyers, focused on and over weighted positive attributes of the item and under weighted negative attributes. Thus buyers and sellers have different composite mental perceptions of the same physical object wherein the "package" of features seen by sellers is greater in number and value than that of buyers. While the items being traded in these experiments were consumer goods, it is reasonable to assume that the sale of financial assets might be subject to the same framing behavior.

Changing Names With Style: Mutual Fund Name Changes And Their Effects on Fund Flows

By Michael Cooper, Huseyin Gulen and P. Raghavendra Rau

Journal of Finance, Vol. 60, No. 6, December 2005, pp. 2825- 2858.

Marketing research professionals have known for years that merely changing the name of a product can have a significant influence on product demand. Surprisingly, this is one of the first academic studies to examine name changes and change in demand for mutual fund shares, holding constant other factors.

Using market data for 296 mutual funds experiencing name changes over the period 1994 to 2001, the authors find that name changes associated with references to currently "hot' investment styles were associated with abnormal net inflows on the order of 27% for the year following the name change. This happened regardless of whether the change was merely cosmetic and didn't reflect any significant changes in actual portfolio behavior or performance. Mutual funds changing names were characterized by poor performance, negative fund flows and low marketing effort before the fund name change. On average, investors investing into these name change funds lost money with the switch. On balance it appears that these name changes were timed to trick investors into believing that the name change was associated with a hot fund style and that better performance could therefore be expected. Apparently honesty is just as rare in the mutual fund industry as in other lines of business endeavor and many investors are easy targets for professional misrepresentation.

Analyst Impartiality and Investment Banking Relationships

By Patricia O'Brien, Maureen McNichols, and Hsiou-Wei Lin

Journal of Accounting Research, Vol. 43, No. 4, September, 2005, pp. 623–650.

This paper uses market data to investigate whether affiliated analysts of investment banking firms are slower to issue negative information about their client's stocks. Using a sample of 3,731 companies making public offerings thru 134 investment banks between 1994 and 2001, the authors find that affiliated analysts issue downgrade recommendations more slowly and upgrade recommendations more quickly than unaffiliated analysts. In addition, affiliated analysts issue positive recommendations sooner and in greater volume just following a client public offering than do unaffiliated analysts. All stocks were followed for a two year period following a new public offering The results of this study are consistent with other research suggesting that analysts of affiliated investment banks tend to issue positively biased and timed information about investment clients stock. They conclude that investment banking ties create a conflict of interest for affiliated analysts and the conflict is manifested in a tendency to issue information that is positively biased and framed toward the client.

The Proximity Heuristic in Judgments of Accident Probabilities

By Karl Halvor Teigen

British Journal of Psychology, Vol. 96, 2005, pp. 423–440.

The Proximity Heuristic is the tendency for decision makers to judge the probability of an outcome by its spatial, temporal or conceptual distance from a target. For example, the probability of a negative outcome may be seen to be more likely if a close friend experienced such an outcome. Similarly, a positive outcome may be judged to be more likely if a positive as opposed to a negative outcome has just been imagined. In effect it is hypothesized that decision makers use closeness as a proxy for probability. In a series of six laboratory experiments the author finds evidence in support of a Proximity Heuristic use in accident scenarios. The probability of an accident is estimated to be high when a disastrous outcome is seen to be close. This often leads to situations where hypothetical accidents are imagined to be more likely than factual accidents.

The Proximity Heuristic would appear to have implications for investment behavior. Specifically, estimated probabilities of good and bad outcomes might be biased by "closeness frames". For example, the probability of a negative or positive stock return might be influenced by whether the stock was "thought of" as well known (conceptually close).

Investment Decisions and Time Horizons: Risk Perception and Risk Behavior in Repeated Gambles

By Alexander Klos, Elke Weber and Martin Weber

Management Science, Vol. 51, N0. 12, December 2005, pp. 1777–1790.

Much previous research dealing with single play gambles has indicated that perceived risk is more highly related to downside potential than it is to measures of outcome variability, such as variance. This paper is important because it confirms that risk perceptions in repeated gambles (5x to 50x) are formed in much the same fashion as in single play situations. Subjects were presented with a number of two outcome gambles that when sequentially repeated formed symmetric or skewed distributions of possible outcomes over time. Subjects also answered questions about beliefs about future outcomes, made choices between gambles and gave certainty equivalents for proposed gambles.

Using a series of hypothetical lotteries the authors conclude that:

1. Perceived risk varies directly with probability of loss, mean excess loss, and coefficient of variation. In effect, subjects were loss averse.
2. Perceived risk does not appear to be related to the standard deviation of outcomes.
3. Choice was a function of lottery expected value and perceived risk.
4. Subjects realized that probability of loss decreased with the number of repeated plays yet subjects strongly overestimated the probability of loss.

Intra Generational Trust: A Semi Experimental Study of Trust Among Different Generations

By Hakan Holm and Paul Nystedt

Journal of Economic Behavior and Organization, Vol. 58, 2005, pp. 403–419.

Previous research has confirmed that feelings of trust have significant investment implications. For example, trust appears to be strongly related to perceptions of risk and that investors perceive less risk in situations where they have greater trust in advisors or investment managers. The objective of this paper was to study trust and trustworthiness between different age cohorts and genders. This research is significant because age and gender differences are quite common between investors and advisors.

This laboratory study used the "trust game" to measure trust and trustworthiness in a series of experiments. In this game players are divided into pairs. One player receives a sum of money and decides how much to send to his/her partner. The experimenter then triples the amount given to the receiving partner and the receiving partner can then send some money back to the initiating partner. Trust and trustworthiness are measured by the amounts of money exchanged between partners. Age cohorts were limited to men and women either 20 or 70 years of age and real money was exchanged.

Results suggested that young players displayed greater trust overall in that they sent about 24% more money to their partners than did older players. It was also the case that, in general, players preferred to trust others in their own age cohort. The authors speculate that this is due to the fact that players of the same age cohort believe that they can more easily infer the mental state of people about their same age. Finally, there was a very strong gender effect. In particular, women were both more trusting and perceived to be considerably more trustworthy than men.