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## RESEARCH ELSEWHERE

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Robert A. Olsen

### The Influence of Culture: Holistic Versus Analytic Perception

By Richard Nisbett and Yuri Miyamoto

*Trends in Cognitive Science*, Vol. 9, No. 10, 2006, pp. 467–473.

One of the long held assumptions about human cognition and perception has been that human information processing is largely culturally invariant. However more recent research has shown that perceptual and cognitive processes may be significantly influenced by cultural practices. For example, studies of inference suggest that Westerners tend to attribute events to causes internal to the object whereas Asians are more likely to attribute causality to the context or situation. Similarly, Westerners are more likely to use categorization and rules in reasoning about everyday events whereas Asians are more likely to emphasize relationships and similarities.

This laboratory study finds that Westerners, more than Asians, tend to engage in context independent analytic processing by focusing on salient objects to the exclusion of contextual attributes. More generally, Asians tend to evaluate a decision situation in a more holistic fashion than do Westerners by giving greater emphasis to the relationships and similarities among objects in the decision environment. Very often these perceptual and attention differences are so large that Asians and Westerners make different choices in identical situations. It is hypothesized that Westerners lesser attention to context stems from the greater emphasis on their more independent and individualistic

social circumstances and beliefs. In particular it has been found that very young Western and Asian children show the same holistic perceptions but that with socialization, Western children are already beginning to ignore context by the age of 4.

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### Industry Effects of Analyst Stock Revisions

By Aigbe Akhigbe, Jeff Madura and Melinda Newman

*The Journal of Financial Research*, Vol. 29, No. 2, 2006, pp. 181–196.

Previous research has suggested that stock prices are subject to a “contagion effect”. Specifically, it has been noted that economic events that should be unique to a single firm in an industry often have similar stock price effects on other firms in the same industry. This more extensive study, utilizing information on approximately 20,000 common stock upgrades and downgrades from the First Call database for the period 1997–2002, strongly supports previous evidence of statistically significant contagion effects. In addition, the study identifies firm and industry attributes that enhance or diminish the contagion effect. In particular, the authors find that price contagion effects vary directly with the magnitude of the initial firm down or upgrade, the size of the downgraded or upgraded firm, the concentration in the industry, the number of analysts following the “re-graded” firm and the amount of prior “re-grading” which has been taking place in the industry. Conversely, price contagion effects vary inversely with firm growth rates, and where systematic risk levels are significantly differently between firms in the industry.

The authors also find that sometimes there are small inverse competitive price effects (i.e. the price of the competitor’s stock rises when another firm is downgraded) associated with “regarding” but that positive contagion effects generally dominate.

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### Process Utility and Help Seeking: What Do People Want From Experts?

By Tom R. Tyler

*Journal of Economic Psychology*, Vol. 27, No.4, 2006, pp. 360–376.

It has recently been suggested that decision makers are motivated by issues of “process utility”. That is, they value certain procedures for obtaining outcomes more than other procedures, irrespective of the outcome. Using data gathered from non-expert investors, the author confirms that investors’ utilities extend beyond purely financial return. More specifically, it is found that investors trade off expected return for the opportunity to participate in the investment decision, to be treated with respect, and to have personal consideration of their needs and values. It is hypothesized that investors value these attributes because they add to the investor’s feelings of status and self worth. That is, at the margin, some investors are willing to trade off investment return for social status.

An alternative possibility is that a more inclusive and personalized expert consultation process enhances trust and thus reduces perceived risk. Because perceived risk is reduced, risk averse investors then settle for lower expected return. Evidence for this possibility comes from numerous studies indicating that novice investors often see moral trust in an advisor as more important than technical expertise and that trust reduces perceptions of risk.

### Metaphors and the Market: Consequences and Preconditions of Agent and Object Metaphors in Stock Market Commentary

By Michael Morris, Oliver Sheldon, Daniel Ames and Maia Young

*Organizational Behavior and Human Decision Processes*, Vol.101, No.2., 2006

Suppose you just heard a stock market commentator say: “Today the market bounced back like a champion prize fighter after a knockdown”. Alternatively, suppose another commentator said of the same incident: “Today the market bounced back like a rubber ball”. Would your market forecast and investment behavior be differently influenced by these two metaphors?

In this very interesting experimental study, the authors find that Agent based metaphors, like the “prize fighter” reference above, lead investors to forecast a continuance of a trend while object metaphors, like the

rubber ball reference, do not. The apparent reason for this difference is that Agent based metaphors suggest a goal and disposition and imply volition whereas object metaphors do not. It was also found that when trend information was presented graphically, as opposed to being displayed in tabular format, that investors more often forecast the continuance of trends.

Finally, the authors discovered that, in general, market commentators tended to use Agent metaphors when the market was rising and Object metaphors when it was declining. However, the use of Agent based metaphors was most noticeable when the market trend was consistently in one direction, with relatively little variation. The authors conclude that investors behave in much the same way as other decision makers when subjected to information that is presented metaphorically.

### Framing Effects and Risk Perception: The Effect of Prior Performance Presentation Format on Investment Fund Choice

By Stephen Diacon and John Hasseldine

*Journal of Economic Psychology*, Vol. 27, No. 6, 2006.

In this experimental study using non-professional investors as subjects, the authors found that risk perceptions were greater when past performance data was presented in bar charts as opposed to graphical (line) form. This effect was most pronounced in the case of equities as opposed to fixed income securities. In particular, about 20% of the respondents switched their portfolios toward greater fixed income security allocations when presented with return yield data in bar chart, as opposed to graphical form. This result was unexpected since most investors stated that data in bar chart form was easier to understand. There was evidence to indicate that the result primarily stemmed from a tendency to perceive a greater chance of losing a large amount of money when returns were displayed as bar chart yields. The study also adds to existing evidence that investment risk is a multi attribute concept containing identifiable separable elements such as: chance of a large loss, potential variability in return over time, ambiguity in the forecast of possible returns and trust in managers and advisors.

A second part of the study reported that length of the prior performance period had little effect on investors risk perceptions or portfolio choices. In particular, there was little difference in investors’ attitudes or behaviors when presented with 45 months versus 12 months of past performance data.

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### Investor Sentiment and the Pre-IPO Markets

By Francesca Cornell, David  
and Alexander Ljungqvist

*Journal of Finance*, Vol. 61, No. 3, 2006, pp.  
1187–1216.

The IPO pricing literature has become massive, if not tedious. Nevertheless, this IPO study is worth examination because it uses a unique European database to ferret out evidence of over optimism on the part of small non professional investors. In particular, in Europe there is often a “gray forward market” in the yet to be issued IPO shares of European companies. This market is primarily inhabited by small non professional investors. Thus it is possible to obtain some information about small investor over/under optimism by comparing the gray market prices with the aftermarket prices.

The data set consists of 2,723 IPOs from 486 European companies covering the period 1995 to 2002. The principal finding is that gray market prices are highly correlated with aftermarket prices when gray market prices are high. Also, price reversals in the aftermarket tend to be correlated with high gray market prices and after market trading volume is high when gray market prices are high. In addition, gray market shares with high prices tend to under perform in the year following issue. In general, prices decline by about 12% to 21% in the year of issue. The authors estimate that gray market investors cause shares to trade about 40% higher at the start of the first trading day than they would in the absence of the gray market demand. It appears that book building professional investors profit by offloading their overpriced shares in the aftermarket to the overoptimistic small investors. When small investors are overly pessimistic and gray market prices are low, professional investors do not sell their shares to small investors in the aftermarket. Thus when small investors are overly pessimistic there is little or no correlation between gray and aftermarket prices.

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### Effects of Extreme Priced Products on Consumer Reservation Prices

By Aradhna Krishna, Mary Wagner and  
Carolyn Yoon

*Journal of Consumer Psychology*, Vol. 16, No. 2,  
2006, pp. 176–190.

What is the relevance to security pricing of home bread makers selling for \$1000 and coats for \$11,500? Well if financial securities are affectively evaluated in a fashion similar to consumer products, the odds are that

the prices that investors are willing to pay for stocks of firms in industry  $\times$  will be influenced by the existence of an overpriced stock of another firm in industry X.

The authors note that some retailers have been known to include a few products in their catalogs and stores at outrageously high prices (not expecting to sell them, of course!) because they suspect that it allows them to sell more ordinary but similar products at slightly higher prices than would otherwise be the case. To test this hypothesis the authors conducted a number of laboratory experiments examining the conditions under which such an influence might exist. In general, the authors found that such a biasing effect was quite apparent, especially when the extreme priced product appeared to have similar attributes and to exist in close temporal and physical proximity to the target product. For example it was found that the reservation prices of all digital cameras of a certain style could be raised appreciably by the existence of a super special digital camera selling at a very high price. In addition it was found that the biasing effect was greatest when a concrete analytical comparison between the high priced and target product was difficult.

Given these findings, it appears that additional study of this phenomenon might be worthwhile from an industry perspective. There is already evidence of stock price contagion effects related to operational and regulatory issues. Might not investors be willing to pay more for a share of xyz just because its competitor is selling for \$\$\$xyz a share?

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### Investor Overreaction During Market Declines: Evidence From the 1997 Asian Financial Crisis

By David Michayluk and Karyn Neuhauser

*Journal of Financial Research*, Vol. 29, No. 2, 2006,  
pp. 217–2

This market based study is unique because it carefully examines the price and trading behavior for 6,276 stocks for the few days surrounding the October 27, 1997 market decline caused by the Asian financial crisis. Thus this is one of the few studies to link market price movements to a clearly identifiable single news event.

The market overreaction hypothesis makes the specific prediction that the magnitude of price reversals should be proportional to the magnitude of the initial price change. Consistent with this hypothesis, the authors find that there was a near monotonic pattern of price reversals in the day following the initial decline, with the stocks suffering the greatest declines experiencing the largest reversals. Within one day of the market break, about 67% of all the declines had been erased. Virtually all stocks had fully recovered within

one week. They also document that the stocks of larger firms and those having higher Betas experienced the largest and quickest rebounds. While it is clear that market uncertainty increased with the Asian news, there is nothing to suggest that uncertainty was resolved within a few days following the decline and thus uncertainty resolution could hardly have been the reason for the quick overall market rebound.

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### **The Priority Heuristic: Making Choices Without Tradeoffs**

By Eduard Brandstatter, Gerd Gigerenzer and Ralph Hertwig

*Psychological Review*, Vol. 113, No. 2, 2006, pp. 409–432.

A significant body of empirical evidence now supports the hypothesis that real world decision makers very seldom act in a fashion that is consistent with the axioms of Utility Theory. Most recent research suggests that decision makers rely upon heuristics or various rules of thumb when making decisions. Thus a question arises of whether it is possible to identify decision heuristics that would allow a general decision making model to be identified. The authors of this paper suggest that their “Priority Heuristic” offers such a potential opportunity.

After reviewing a large body of decision making research, the authors conclude that a likely heuristic is one that assumes that decision makers compare risky alternatives by sequentially analyzing each of them beginning with the attribute “minimum possible gain” and ending with the attribute “the probability of the maximum gain”. Empirical evidence suggests minimum gain appears to be the most important decision attribute while the probability of the maximum gain is the least important attribute. Accompanying this “Priority Heuristic” is a “Stopping Rule” that says to stop the examination of alternatives if the gains differ by less than approximately 10% of the maximum gain.

The authors compare the performance of this heuristic against other decision models by applying them to an extensive set of typical risky decisions. They find that this “frugal” decision rule (it does not assume summing or weighting) predicts 87% of the actual decisions made by experimental subjects, a far larger percentage than predicted by other common models. In addition they demonstrate that the “Priority Heuristic” is simultaneously able to explain the Allais Paradox, risk aversion for gains where probabilities are high, risk seeking when probabilities are low, risk aversion for losses when probabilities are low, risk seeking for losses when probabilities are high, the certainty effect and the possibility effect. No other single model was able to account for all of these commonly observed decision behaviors.

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