## Dissecting Decisions

***To the Editor:***

After reading "Behavioral Idiosyncrasies and How They May Affect Investment Decisions," in the October 1997 issue, I thought I'd share my impressions of the types of studies used to flesh out "investor behavior."

While in MBA classes over the past three years (with 20 years in the workforce), I was exposed to countless behavioral studies and experiments similar to those used to support the conclusions drawn in the article. Such studies share a common flaw—in the interest of producing reportable data, researchers often oversimplify what are actually complex situations where decisions are made using several levels of cognition.

As an active investor, I've come to appreciate how my own buy, sell and hold decisions are made using input from many sources of sometimes conflicting information. I find it ludicrous that academic studies rely on hypothetical situations that don't include risk, to explain behavior that involves real money.

For example, the article described a study where "pride of ownership" compelled coffee mug sellers to ask for much higher prices than mug buyers were willing to pay. Researchers then extrapolated from these results an explanation of investor "endowment behavior," where sellers miss opportunities to sell stocks at the appropriate time because they've developed an unnatural affection for their possession—the stock. What rubbish!

These buyers and sellers of mugs had no real risk or commitment to the transactions. The situation was artificial and devoid of consequence—the antithesis of real investing. Mug sellers didn't stand to actually pocket real dollars, and buyers certainly weren't involved in this activity to acquire mugs. The only likely motivation for activity would be the subjects' eagerness to cooperate and please the authority figures running the experiment.

As to why investors miss the best sell times, I believe it's due to a combination of reasons. As a stock price climbs, the natural inclination is to try to sell at or near the peak—always a difficult call. It takes real discipline to stick to a sell rule, such as one based on a percent increase over the buy price. Missed profits can be based on greed—always waiting for the next uptick—or in some cases, laziness—the investor doesn't put forth the effort to study and follow the stock carefully. Ignorance of good rules, or dependence on brokers can also limit gains. Even successful, disciplined investors must struggle with data from many sources. News, market trends, individual stock behavior, experience, earnings expectations, company management, and sector strength all influence when to sell. And with each analysis and decision process comes the baggage of knowing that, at least in the case of the average AAII member, it's his own real money.

I acknowledge that investors sometimes act irrationally, but I reject the notion that it's explainable on a wholesale basis by simplistic behavioral experiments. Most individual investors are relatively sophisticated people, and I doubt that their investment behavior mimics pretend mug sales.

**George A. Ellis**
**Butler, Pennsylvania**

***To the Editor:***

In the excellent article on behavioral idiosyncrasies and investment decisions, Campanale and Skakun ignore the effect that large sums of money are not linear in their real value.

The example of the one-in-a-thousand chance of winning $5,000 versus certainty of winning $5 reflects this. The certain chance makes no significant difference (a cheap lunch), but the jackpot represents a nice vacation.

Similarly, if I am retired and have $1,000,000 and you offer me $10 to $9 on a coin flip, I take the bet but it does not matter. If you offer me $1,000,000 to $900,000, the bet does not offer good odds. If I lose, I don't have enough money to live on, and am permanently poor. If I win, I won't live twice as well, and certainly not better enough to make up for the risk.

The authors' analysis of risk-averse behavior may, in part, represent people giving rational assessment of value odds as opposed to pure money odds.

**Richard Budd**
**Portland, Maine**

***To the Editor:***

Regarding the October 1997 article, "Behavioral Idiosyncrasies and How They Affect Investment Decisions": This article was certainly timely! As we watched the poor lemmings leaping on Grey Monday, we could have added a new subchapter to the article!

A good friend is always saying "know yourself" before you become an active investor. Much of the article was in tune with his thinking. Thanks for presenting this summary of recent market psychological study.

**Tom Veale**
**Port Washington, Wisconsin**