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Subject Fw: ABFGLA January/February 2010 Newsletter

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Upcoming Events

- **University of Tennessee at Chattanooga** is developing a degree program to teach trading and financial management from a more holistic perspective, including elements of behavioral finance, brain chemistry, and gender influence on decision making. The program has been enabled by founding donors Renee Haugerud and her husband, John H. Murphy. For more information and details on the program launch (expected soon), contact Jennifer Stanley at jennifer-stanley@utc.edu.
- **2010 Economic and Investments Forecast Dinner**, Dr. Sri-Kumar and Tom Higgins join Don Straszheim to share outlook for the coming year. Thursday, February 25th, 2010 at the Omni Hotel in downtown Los Angeles -- 5:00 to 8:00pm. Additional information and registration available at - <http://www.cfala.org/i4a/pages/index.cfm?pageid=3643>
- **2010 CFA Institute Annual Conference**, will include presentations by Dan Ariely of Duke University and Richard Peterson, author of Inside the Investor's Brain, May 16 -- 19 in Boston Massachusetts. For information and registration -- <http://www.cfainstitute.org/memresources/conferences/100516/index.html>
- **The Interdisciplinary Group in Behavioral Decision Making at UCLA** has a number of programs in the January -- March time frame. To view speakers and their topics -- <http://www.anderson.ucla.edu/x9484.xml>
- **Second Annual Meeting of the Academy of Behavioral Finance & Economics- 2010, September 15-17, 2010, Chicago, Illinois** www.aobf.org

Newsletter

This is a bimonthly newsletter from the Applied Behavioral Finance Group (ABFG), An Associated Group of the CFA Society of Los Angeles, CA.

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Observations

As 2010 begins, we find ourselves shaking off the dust of the last couple of years and moving into a new decade. My analogy is that we have been on an economic (and emotional) rollercoaster that has slowly eased into the home platform to load a fresh crop of passengers with mixed expectations for the next ride. The only kicker is that we don't have the option to get off. My hope is that we have upgraded our collective resilience and will therefore more effectively anticipate the drops, lean left or right in order to ease the emotional hammering that will inevitably come.

I am encouraged (optimist that I am) at the continuing emergence of great research about decision making and human interactions -- particularly group dynamics - which hopefully will enhance our capacities for change and thus adaptive skills to address the unexpected more effectively.

Currently, I am knee deep (neck is probably better) in two books, ***Trust and Reciprocity*** (Elinor Ostrom and James Walker, editors) and ***Bounded Rationality*** (Gerd Gigerenzer and Reinhard Selten, editors). Both are compendiums of research by a number of academics. Tackle the first only with a pot of strong coffee at hand. So far I've unearthed several good ideas about how we might evaluate our ability to trust others sufficiently to put ourselves at risk with them. The second is a more pragmatic expose into how we might be more efficient at making decisions -- how to reduce "analysis paralysis". Look for more specifics (summarized of course) either on our website, or a future newsletter. Meanwhile, we send you our ***warmest wishes for a prosperous New Year!*** - your friends at the Applied Behavioral Finance Group in Los Angeles.

Your editor

Mission

To identify, evaluate, and disseminate information and activities in the field of behavioral finance. Our objective is to enhance collaboration between research and practitioners in order to produce practical applications of value for investors and professionals who serve them.

Website

www.abfgla.com

Websites of Interest

From Don Steinmann (ABFGLA):

Here are some blogs and discussion groups that provide opportunities to interact on the topic of behavioral finance and hear what different voices (skilled and not) have to say about the subject.

Yahoo discussion group about Behavioral Finance

<http://finance.groups.yahoo.com/group/Behavioral-Finance/>

Business Week Magazine News and Blogs about Behavioral Finance

<http://bx.businessweek.com/behavioral-finance>

The Behavioral Economics Consulting Group Blog

<http://www.becglc.com/>

Wordpress Behavioral Economics Blog

<http://en.wordpress.com/tag/behavioral-economics/>

From Victor Ricciardi (Social Science Research Network):

FinaMetrica (a behavioral finance research firm) is conducting a survey on various financial issues. As part of this project, I have been working with the FinaMetrica team in developing and incorporating questions on negative emotions. My contribution to this endeavor are questions 11 through 21, that ask about the notion of worry among investors. (This is an extension of my research from the working paper *The Financial Psychology of Worry and Women*.)

This is the weblink to the introduction page of the survey:

<http://www.riskprofiling.com/freeprofile/>

This is the weblink to the current survey including Questions 11 through 21 on the notion of worry:

<http://www.riskprofiling.com/freeprofile/survey.htm>

The FinaMetrica Risk Profile weblink is also posted under the Section "Dealing With Risk" on the PBS website for the special behavioral finance series "Your Mind & Your Money" sponsored by the Nightly Business Report, Investor Education Foundation, and Kiplinger's Personal Finance Magazine at

http://www.pbs.org/nbr/site/features/special/mind_and_money/

Victor's contact information is:

SSRN Coordinator: Behavioral & Experimental Research Social Science Research Network (SSRN) at <http://www.ssrn.com> (website)

victor_ricciardi@ssrn.com (email address)

Download his papers at:

http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=262799

Editor, SSRN Behavioral & Experimental Finance eJournal

http://www.ssrn.com/update/fen/fen_behav-exper-fin.html

Editor, SSRN Behavioral & Experimental Finance (Editor's Choice)

eJournal http://www.ssrn.com/update/fen/fen_beh-fin-editor-choice.html

From Greg Seals (CFA Institute):

Link to resources available on the CFA Institute Life Long Learning:

<http://www.cfainstitute.org/memresources/education/behavior.html>

Link to an interviews with several luminaries in behavioral finance by Nightly Business Report:

<http://www.pbs.org/nbr/info/local-player.html?s=nbre07s33a7qbad>

Book Review

The Unbounded Mind: Breaking the Chains of Traditional Business Thinking by Ian I. Mitroff and Harold A. Linstone (Oxford University Press 1993)

A review by Mark Harbour, Editor, The Applied Behavioral Finance Group Digest

In my opinion, the events of the last year may provide ample reason to question why we continue to apply the same methods (think "Not so" Modern Portfolio Theory) to the same problems (mitigating risk in portfolio construction). It may be time to re-think our approach.

While the book that is the subject of this review was written substantially

before the current crisis, the education, experience, and practical seasoning of the authors with regard to systems management and organizational behavior is extensive. They outline thoughtful perspective, pragmatic insights, and creatively adaptive methods in how to organize decision making in a world of complexity; concepts of remarkably timeless value to us today.

I particularly enjoyed one of the early observations of the authors that "Data and information do not automatically lead to greater insight; they may now travel at the speed of light, but understanding and wisdom do not."

The book outlines four traditional ways of thinking (inquiry systems - **IS**) that the authors suggest have value. However, each has limitations and is appropriately applied in some but not all environments. They categorize the four as follows:

1. **Inductive-consensual** -- agreement or a general conclusion is sought on the basis of a limited set of observations. In the end, the authors suggest it is appropriate to seek agreement or consensus, but caution us not to trust them fully.
2. **Analytic-deductive** -- knowledge is obtained by breaking complex multi-part tasks down into segments. Useful formulae and logic can then be applied. A single solution is usually the result. Situations here are either true or not true, but cannot be both simultaneously. The authors caution that "...precision and clarity may lead us deeper into deception and not rescue us from it."
3. **Multiple realities** -- suggests that data, facts, and observations are inseparable in principle from the theory or model that we construct of a problem. In this method, models are not drawn from a single discipline (such as economics, physics, psychology), but from a range of them. The production of multiple views of a problem is an explicit requirement for inquiry and for knowledge itself. Uncertainty is a fundamental characteristic in the process of knowing. Flaws in this system include the presupposition that the science of logic always applies, assertions cannot be true and false simultaneously, the world is seen in a dichotomy of "problems" and "solutions", and objectivity is seen as a primary element in producing a single "best" solution. Reductionism is practiced in this process that boils the decisions down to a more manageable set of sub-components.
4. **Conflict** -- is the process of deliberately engaging opposing views who argue their case before a decision maker. The most obvious illustration of this IS can be found in our legal system in which a jury hears the prosecution and defense arguments and is expected to reach a decision about the "truth" for the imposition of a "just" decision. There are numerous explanations of faulty jury decisions and documented flaws in our legal system to illustrate how this system can and does go wrong.

The ultimate method of learning that the authors advocate is **unbounded systems thinking** . The elements that characterize this method are:

- Everything interacts with everything. (facts and situations are time varying and not stable).

- Every one of the sciences and professions is considered fundamental; none is superior to or better than any other.
- All **IS** s are interdependent or mutually dependent on one another.

The formula that the authors suggest we use in identifying information contributing to the process of this system is to actively incorporate viewpoints from each of the following perspectives:

- **Technical** (the scientific, logic, formula driven aspects)
- **Organizational or Societal** (group dynamic and objectives unique to that perspective)
- **Personal or Individual** (the specific psychology and heuristics unique to the participants)

By following this perspective building proscriptio, the authors suggest that the inputs to the evolution of thinking are more likely to include a broader view of the environment and thus the significant factors crucial to an effective decision process.

The authors cite a number of examples helpful in illustrating pitfalls and benefits associated with the various methods of thought including a particularly insightful retrospective of the chemical plant catastrophe in Bhopal, India which occurred in 1984. Their methods highlight the sorts of process questions and resulting actions that, if implemented by the company, could have prevented the disaster.

Whether the methods and perspective of unbounded systems thinking could have been engaged to highlight conditions that contributed to the recent financial meltdown -- and therefore have provided for any individual an early warning sign to take action is hindsight, but I suspect engaging a more complex set of information resources as an input to our decision process would certainly have enhanced our chances of doing so.

In the final chapter, I think appropriately, the authors cite the relevance of including ethics as an important element in our information systems. "**Ideals serve as critical benchmarks**" is a sample of a relevant thought in assessing the validity of our efforts as well as "**Every philosophy is measured not only by what it achieves, but by its aspirations** ." Finally, there are obviously a number of research studies regarding behavioral finance (individual decision making biases, group dynamics, and neuroscience) that have emerged during the last 16 years that the authors did not have the benefit of previewing. This research can clearly augment the framework outlined in this book; and is appropriate to include as an enhancement to the methods outlined. Regardless, the basic conceptual framework that these authors describe has a timeless quality that can add valuable perspective in assessing our approach to decisions in a world of complexity.

Editor's Invitation

Please share items of interest with the group by sending to Mark Harbour, Editor, ABFG Newsletter at harboal@ca.rr.com.

We invite you to view our website, www.abfgla.com, and share reactions, ideas, or other information of interest.

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