Meet Meir Statman

By Editor Test *Tue, Sep 7, 2010*

Click on the headline to watch a four-minute video of Meir Statman discussing his new book "What Investors Really Want," or to read several brief excerpts from the book itself.

Economists once assumed, perhaps for the sake of sheer convenience, that the typical investor was a paragon of rationality, always able to apply his or her highest, most objective reasoning abilities to financial decisions.

Now we know that an assortment of psychological, biological, and cultural factors, mediated by ineffable hormones and neurotransmitters, shape the way we measure risk and reward and how we spend our money.

These mental and physical factors are the subject of the new book, *What Investors Really Want* (McGraw Hill, 2010), by Meir Statman, the Glenn Klimek professor of finance at Santa Clara University near San Jose, California. As the following excerpts show, the book draws on a wide range of evidence and reveals the complexities of behavioral finance in language that's accessible to almost anyone.

Take, for instance, Statman's description of an experiment where researchers tested children's ability to delay gratification–a process linked to financial behavior. The children were promised an extra marshmallow if they were able to wait patiently for a teacher to return to their playroom after a short absence:

"Imagine yourself as a four-year-old at a nursery school. A teacher escorts you into a room and together you play with some toys. Then the teacher says that you would play again with these toys some more later but asks you to sit for now at a table on which there is a bell.

"The teacher shows you two marshmallows and says that he or she must leave for a while. If you wait until the teacher comes back, you can have the two marshmallows. You can ring the bell at any time you want to call the teacher back, but if you ring the bell you'll get only one marshmallow, not two. Would you be able to resist the urge to ring the bell before 15 minutes is up?

"Children who resist the temptation to ring the bell have better self-control than children who ring the bell, and differences in self-control have profound consequences in life, including financial life. Children who exercised sufficient self-control to resist the temptation of the marshmallow grew up to be more academically and socially competent, verbally fluent, smart, attentive, able to plan, and able to deal with frustration and stress. They also scored higher on the SAT."

Aside from psychological processes, there are also physiological processes for some of our financial decisions, Statman writes. He cites research showing that people who eat turkey and other foods high in tryptophan, an amino acid that is a chemical precursor of serotonin, a neurotransmitter that affects mood and activity levels, are less likely to act on impulse than people who eat high-carbohydrate foods.

“People who had the traditional Thanksgiving dinner exhibited lower impulsiveness, reflected in a lower willingness to buy a Dell Home Inspiron personal computer on Black Friday, than people who had pizza, quesadilla, lasagna, pasta, burrito, salmon, or noodles,” he writes.

Along with the link between impulsivity and neurotransmitters, a physiologic link has been found between a certain region of the brain and the reaction to prices in certain people, Statman’s research shows. He describes an experiment where people were given an MRI while seeing a product, then its price, and then being asked whether they would like to buy it or not:

“Seeing the price caused greater activation in the insula among people who decided not to buy the product than among people whose choice to buy. The insula is a brain region associated with painful sensations such as social exclusion and disgusting odors.”

Some of our behavior is more easily traced to cultural influences, rather than physiological or psychological ones. For instance, “More than 32% of Japanese parents plan to leave a greater amount to the child who takes care of them in old age, while only 2.5% of American parents plan to do so,” Statman writes. “More than 7% of Japanese parents plan to give more to the oldest son or daughter and almost 7% plan to give more to the child who continues a parent’s business, while such plans are almost absent among American parents.”

Whether culturally-instilled or psychological, Statman’s book shows that the fear of poverty affects virtually all of us on a deep level, and freedom from that fear appears to be a blessing that’s as satisfying than wealth. That’s one of Statman’s principal arguments in favor of owning income annuities or choosing to annuitize a defined benefit pension.

“Freedom from the fear of poverty improves our mental health as riches do,” he writes. “Retirees who have at least some of their income in the form of pensions or annuities have greater freedom from the fear of poverty than retirees who draw income from their savings, concerned that they might outlive their money.

“Retirees with pensions or annuities were more satisfied with their life in retirement than retirees with similar incomes from sources other than pensions or annuities. Retirees with pensions or annuities also had fewer symptoms of depression than retirees without such pensions or annuities.”

Even the sense that we are poor compared to other people can drive us to make somewhat risky, and even desperate decisions, the research shows. As Statman puts it, “We are driven to gamble when we are reminded that we are poor.”

He describes an experiment where people waiting at a bus station were paid “$5 in single dollar bills to complete a questionnaire. One version of the questionnaire, given to half the people, was designed to make them feel adequate, with incomes in the middle of the income range. It asked whether their annual incomes were less than $10,000, between $10,000 and $20,000, and then, in increments, to the top category of more than $60,000.

“The other version of the questionnaire, given to the other half, was designed to make them feel poor. It asked whether their annual incomes were less than $100,000, between $100,000 and $250,000, and then in increments to the top category of more than $1 million.

“Next, the experimenters showed each person five $1 lottery tickets and asked how many they wished to buy. People who were made to feel poor bought more lottery tickets than people who were made to feel that their incomes were adequate.”