

Wanted: Psychopaths to Play the Stock Market

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by Martin Waller

Stockbrokers have never enjoyed the best of reputations. The popular image is of a brash and boastful twenty-something with more money than sense or sensitivity.

But now a study by a group of eminent American academics suggests that star performers on the stock market may be even worse and could best be described as “functioning psychopaths”.

In a study of investors’ behavior, the team from three US universities suggest that people with brain damage can make better financial decisions than the rest of us.

Market traders may feel slighted, but this study comes from the growing field of neuroeconomics, which investigates the mental processes that drive financial decision-making.

The experts found that emotions can make investors play it too safe. They claim the emotionally impaired are more willing to gamble for high stakes.

The US team found that people with certain brain injuries which suppress their emotions could make the best stock market traders. They took a selection of 41 people of normal IQ, 15 of whom had suffered lesions on the areas of the brain that affect emotions, and made them play a simple investment game.

Those with brain damage significantly outperformed those without, the researchers from Stanford Graduate School of Business, Carnegie Mellon University and the University of Iowa found.

The key was the fear that stopped those with “normal” brains from taking even the most sensible of risks.

Antoine Bechara, an associate Professor of Neurology at Iowa, suggested that successful investors in the stock market might plausibly be called “functional psychopaths”.

These are individuals either much better at controlling their emotions or, perhaps, not experiencing them with the same intensity as others.

Baba Shiv, of Stanford, added chillingly: “Many CEOs (chief executive officers) and many top lawyers might also share this trait.

“Being less emotional can help you in certain situations.”

The study set up a 20-round gambling game, at the start of which participants were given \$20. At each round, they were asked if they wanted to risk \$1 on the toss of a coin.

If they lost, they lost the coin; if they won, they received \$2.50. “From a logical standpoint, the right thing to do was to invest in every round,” Mr. Shiv, an associate Professor of Marketing at the Graduate School of Business at Stanford University.

As the rounds progressed, the “normal” participants passed, becoming cautious and concerned about conserving their winnings. Those with lesions did not, and ended the game with an average of \$25.70, almost \$3 more than the “normal” group.

The study is relevant, the authors say, to the “equity premium puzzle” that has bemused financial experts.

This is the tendency of large numbers of investors to prefer to invest in bonds rather than equities, even though the latter have historically always provided a much higher rate of return.

When stock markets decline, investors shift to bonds, even though over the long term this is not the best thing to do.

Emotions lead people to avoid risks even when the potential benefits far outweigh the losses, a phenomenon known as myopic loss aversion that scholars have concluded can explain, for example, why people invest in bonds over historically higher-performing stocks.

George Loewenstein, a Professor of Economics at Carnegie Mellon and a co-author of the study, said: “It may be the first study that documents a situation in which people with brain damage make better financial decisions than normal people.”

Mr. Shiv said: “Emotions serve an adaptive role in speeding up the decision-making process.

“However, there are circumstances in which a naturally occurring emotional response must be inhibited, so that a deliberate and potentially wiser decision can be made.”

The study does not mean that it is a good thing to have lesions in emotional regions of the brain. Such patients generally make worse decisions than those with intact brains. In this experiment, risk-taking was the most advantageous behavior, so the participants who were less fearful made the better choices.

However, in other studies, the experiment has been set up so that risky choices had lower expected values, and in these studies, normal subjects tended to perform more optimally.

Emotions clearly play an important role in human life. This study suggests, however, that there are situations in which they can lead us astray. “Research needs to determine the circumstances in which emotions can be useful or disruptive, and that can be a guide for human behavior,” Professor Bechara said.