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Genes Control Your Stock Picks (and Other Research)

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In honor of some recent gains in the stock market, a few interesting stock-related studies:

1) **Left-Digit Effect:** Investors buy stocks the same way they shop for toothpaste: They are seduced by prices that end in ".99."

This effect is called the "left-digit effect" — that is, the tendency to pay inordinate attention to the left-most digit in a price, and to read "$2.99″ as being significantly cheaper than "$3.00." An abstract of the paper — which is by Utpal Bhattacharya, Craig W. Holden and Stacey E. Jacobsen at Indiana University-Bloomington — can be found here. Here's a news article explaining the research in more detail.

2) **My Genes Made Me Do It**: This paper argues that investing behavior is at least partly determined by our genes.

Camelia M. Kuhnen and Joan Y. Chiao, both at Northwestern, found that "variants of two genes that regulate dopamine and serotonin neurotransmission and have been previously linked to emotional behavior, anxiety and addiction … are significant determinants of risk-taking in investment decisions."

The results were based on a computer game, in which 65 people each answered 96 questions about how they would invest given sums in a variety of investment options. The subjects were then genotyped.

A news article about this study can be found here. The article also talks about previous research linking financial risk-taking to testosterone.

3) **Congress Destroys the Stock Market**: This one is a few years old, but I saw it only recently when Greg Mankiw blogged about it. Apparently, stock returns are lower and volatility is higher when Congress is in session.

The study was written in 2006 and is by Michael F. Ferguson at the University of Cincinnati and Hugh Douglas Witte at the University of Missouri at Columbia. From the abstract:

This "Congressional Effect" can be quite large — more than 90% of the capital gains over the life of the DJIA have come on days when Congress is out of session. The Effect varies systematically with the public's opinion of Congress: returns are lower and volatility higher when a relatively unpopular Congress is active. Public opinion appears to play a fundamental role in market prices. This is consistent with a mood-based explanation that sees Congress as depressing the average investor. Alternatively, our results can also be reconciled with rational explanations that view Congressional activity as a proxy for regulatory uncertainty or rent-seeking behavior.

4) **Aversion to the Mean**: This study, by Luboš Pástor and Robert F. Stambaugh, finds that, contrary to conventional wisdom, a stock's price doesn't revert to the mean over a long time frame. In fact, "stocks are substantially more volatile over long horizons from an investor's perspective."