Princeton University, Department of Psychology
Pitfalls of Investor Decision-Making in the Social Interaction Context

Problem 1: Halo Effects, Professional Designations, and the Problem of Unwarranted Trust

The General Problem: When entering into a relationship with an investment professional, the first information that one encounters about that person is often superficial. For example, one might notice that person's appearance, educational background, or corporate affiliation. Or, one might attend to that person's *professional designation*. Such designations abound in the investment industry, and they vary in the degree to which they signify training and vetting procedures (e.g., a recent *New York Times* article reported that one can obtain the designation "Certified Senior Advisor" after a three and a half day course). To the extent that people place heavy weight on superficial information or on unimpressive professional designations, they may find themselves placing trust in advisors who otherwise would not have earned it.

Research Strategy: In order to assess whether professional designations produce halo effects, and in order to get a sense for the magnitude of those effects compared to other superficial variables that affect investors' decisions, we conducted an experiment in which research participants read a profile of a "broker" with whom they could entrust their investments. Different participants read different profiles, which varied in terms of professional designations, and also in terms of other superficial characteristics (e.g., dress, education). We tested the effects of these variables on participants' intentions to seek *background checks* and to *invest their savings* with the particular broker.

Summary of Key Results:

- Concerns about the impact of professional designations may be unwarranted. Participants in our experiment did **not** express more interest in investing with a broker who allegedly had a certification in **Senior Citizen Advising** or in **Risk/Reward Analysis**, as compared to a broker with no advanced professional designation. Participants also did **not** view those with either certification as more trustworthy, or competent, or less needy of a background check, and they did not wish to invest more money with them.

- Importantly, participants **over age 50** also did not show any effects of professional designation. Of special note, they were not more positive (on any of the measures we used) towards the broker who had the certification in .Senior Citizen Advising, suggesting that older adults may not be especially prey to that designation.

- The only statistically significant effect involving professional designations was an ironic one: Participants rated the broker with no professional designation as **more competent** than the broker with the certification in "Senior Citizen Advising" and as **more competent** than the broker with the certification in "Risk/Reward Analysis."

- The most striking effects in the experiment involved the broker.s alleged **education**. Most notably, when asked how much of $1000 they would want to invest with the broker whose profile they read, participants wished to invest $515 with a broker who allegedly went to Cornell University as compared with $268 with a broker who allegedly went to Elmira College. The lowest amount they wished to invest was with the casually dressed broker -- with whom they were inclined to invest only $100 -- who allegedly went to Michigan State.

- In terms of education effects, participants also showed a tendency to view the Cornell broker as more **trustworthy** than the Elmira one.

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Problem 2: Manic Thinking and the Problem of Excited Decision-Making

The General Problem: When meeting with a professional to discuss investment options, one often has to digest a good deal of information – numerous options, unfamiliar concepts and terms, complex calculations of risks vs. benefits and short- vs. long-term profits, etc. All of this, packed into a short meeting with an enthusiastic professional, is enough to make anyone's *mind race*. Unfortunately, a racing mind is not a recipe for good decision-making. When thoughts are fast, people become excited and grandiose. What is needed, then, is a way to slow decision-making and promote more careful (and less grandiose) thinking.

Research Strategy: Given the importance of "racing thoughts" for investor behavior, and the possibility of introducing simple methods to limit its damage, an important goal is to learn whether people have such racing thoughts by virtue of interacting with an enthusiastic or fast-talking person (e.g., during a meeting with an eager professional or even a crook posing as one). We tested this question by exposing people, in an experiment, to an alleged broker who spoke fast versus more slowly.

Summary of Key Results:

- Participants listened to an alleged stock broker describe seven potential investments at either a **rapid pace** or at a slower pace. Overall, the pace of his speech made a big difference, as detailed below.

- Participants who listened to the fast-talking broker felt more **energetic**, **happy**, **excited**, and **enthusiastic** than those who listened to the slower-talking broker.

- Importantly, participants **credited the broker** rather than themselves with those positive feelings -- that is, they did not view themselves as any more creative or intelligent after listening to the broker who spoke fast.

- Most critically, participants. positive feelings tended to translate into how they viewed the investment opportunities that the broker presented. Thus, participants who listened to the fast-talking broker showed a general tendency (not significant on each measure individually, but a reliable trend across the set of items) to view the exact same investments as being of **higher quality** and **less risk** when the broker spoke fast, and as of more **interest** to them personally and more **deserving of their money**.

- As an example of participants. greater interest in the investments presented by the fast-talking broker, they were **inclined to invest more money** into the investments after the high-speed presentation. That is, when considering an investment of up to $10,000 in the investment opportunities they had just learned about, they were inclined to invest $2,763 in those opportunities when the broker spoke slowly, but $3,567 in those same opportunities when the broker spoke fast.

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Problem 3: Psychological Proximity and the Problem of Social Pressure

The General Problem: When meeting with an investment professional, people are in a situation with subtle but unmistakable *social pressure*. Lay investors are acutely aware of the difference in knowledge and experience between themselves and their advisor, and they may feel inclined to follow the advice they are given for that reason. Even when they are not naïve and uninformed, and even when they do recognize that a particular decision opposes their self-interest, they may still feel pressured to go along because of very normal motives to get along socially and follow authority. Unfortunately, these motives may lead people to sell their own futures short in order to please another person, even someone they barely know.

Research Strategy: Past experiments suggest that people may make poor investment decisions due to subtle pressures of the social situation (e.g., an advisor's preferences for them). We conducted a series of experiments testing whether those pressures can be increased and decreased as a function of the "psychological distance" between the decision-maker and the person exerting the pressure. We examined whether people are affected by the distance separating them from a financial advisor, both in terms of *physical distance* (i.e., whether the FA is standing over the person as s/he is thinking about the investments) and also *social distance* (i.e., whether the individual expects to see the FA again).

Summary of Key Results:

- On the whole, these studies showed effects of physical proximity that were in the predicted direction. That is, study subjects generally displayed more interest in investments—and indicated that they would invest more dollars in those investments—when the person who advocated those investments stood physically close to them while they were making their investment judgments/decisions. These effects were smaller than expected, though, and they were sensitive to some interesting factors—such as whether the study subjects believed they would ever see the "advisor" (i.e., the experimenter posing as an investment expert) again.

- Study 1: In this experiment, we found a promising result that is consistent with, though somewhat more complicated than, our initial prediction. Subjects yielded to social pressure from the proximal broker (the one who hovered over them while they completed the questionnaire), but that effect was statistically significant only for the first couple of investment opportunities they rated. After that, they acclimated to her presence and were less affected by it. Thus, subjects in the proximal condition tended to report more interest in the first couple of investments they rated when compared to their peers in the non-proximal condition—but they showed no difference for the latter investments.

- Study 2: In this experiment, subjects (adults at a shopping mall, age range 27–82) rated one investment (concerning a luxury property development project). Although the results did not reach statistical significance, there was a clear pattern in the data consistent with our predictions. Participants showed more interest in the investment when the experimenter was physically proximal: A total of 48% said they would consider investing in it when she stood close to them, whereas 33% said they would consider it when she stood further away. On average, participants wished to invest $2100 (out of a $10,000 maximum) when she was proximal, and $1333 when she was distant.

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- Study 3: In this experiment, we examined possible interactive effects of physical proximity (manipulated as in Studies 1 & 2) and social proximity (whether subjects were led to believe that they *would*, versus *would not*, see the experimenter repeatedly in the future). The results showed an interesting effect: Participants only acted "pressured" by the experimenter's physical closeness when they *also* felt socially proximal. That is, subjects indicated a uniquely high willingness to invest in the experimenter's suggestions when he stood over them *and* also led them to believe they would have continued interactions with him. In that condition, they wished to invest $44 (out of $100 maximum), whereas the other three conditions ranged from $33-$36. Unlike in Study 1, this effect was not strongly magnified by looking only at the first two investments (for those, they wished to invest $46 in the doubly-close condition, and $32-$35 in the others).

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