Stock graphs can mislead: People prefer stocks with shorter runs

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Can the way stock information is presented lead investors to make the wrong decisions? A new study in the *Journal of Consumer Research* shows that when investors use charts, they are likely to make a baseless decision about the riskiness of a stock based on its run-length.

Stock graphs are everywhere, available on financial and public websites to be loaded and customized by users. Authors Priya Raghubir (New York University) and Sanjiv R. Das (Santa Clara University) found that investors believe that stocks with shorter up-and-down movements are less risky than those with longer run-length. This is called the "run-length" effect.

They tested three groups -- affluent Californians, undergraduates, and general investors -- and found that all three judged a stock with a shorter run-length more favorably. They found that the run-length effect increases with greater education and frequency, length, and diversity of trading experience.

They conclude that because of the large amount of data presented on a graph, investors simplify their task by sampling points from a financial instrument's price history to estimate trend and noise. The sampling strategy leads to perceptual biases when the sample points are not representative of the price series.

The authors believe there are public policy implications that might lead to how data is presented because "systematic biases in risk perceptions may permeate the market uniformly, resulting in persistent biases in prices. . . From a consumer perspective, individual investors should be made aware of their biases in appraising and comparing stocks using charts."

"These results have implications for how financial information is communicated to investors," the authors write. The visual display of stock information has increased and the number of commercial purveyors of stock analysis information has mushroomed… From a public policy perspective, regulators should consider imposing guidelines about how financial information is presented to individuals, akin to mandatory labeling by the Food and Drug Administration (FDA).

More information: Priya Raghubir and Sanjiv R. Das. " The Long and Short of It: Why Are Stocks with Shorter Runs Preferred?" Journal of Consumer Research: April 2010 (published online September 17, 2009).

Source: University of Chicago (news : web)