



An Internet-based test of the Stock Choice Recognition Heuristic as an investment tool: more successful than experts, market and trust

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Introduction

Simple recognition may be both a powerful force and a useful tool in complex real world domains like stock markets. In an Internet-based study with 160 participants the *recognition heuristic* was tested in a sideways developing stock market against other heuristics like trust in companies, against stock experts and against the market. For strong up-markets Ortmann, Gigerenzer, Borges and Goldstein (2002) and Borges, Goldstein, Ortmann and Gigerenzer (1999) had been able to show that simple heuristics like the recognition heuristic are sometimes surprisingly successful and generate good profits. In order to assess generalizability we also tested the heuristics in different languages and by manipulating the layout of the questionnaire.

Method

The investigation was set up as an Internet-based experiment, because among its many advantages this method allows fast access to many participants from different countries (e.g., Reips, 2002). The design was 2 (language: German, English) x 2 (answering format: one company per page, half the companies per page) x 2 (order: a-z, z-a).

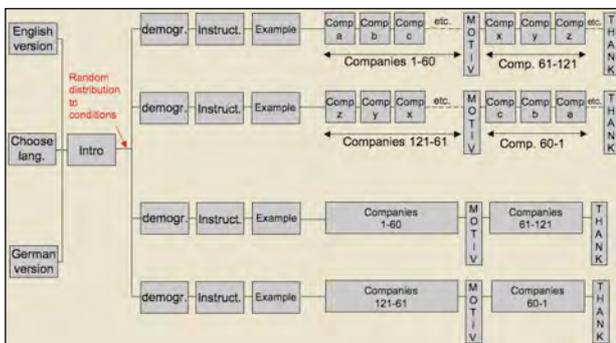


Fig. 1: Schematic display of the study procedure.

Assessment of company recognition was implemented as a dichotomous choice, of company trust on a six point scale.

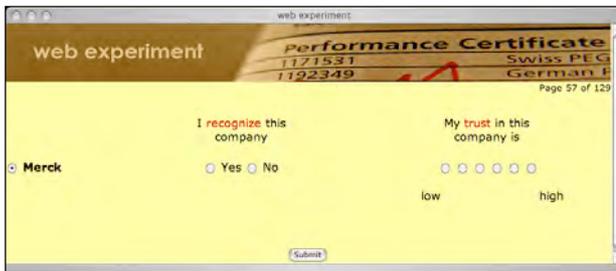


Fig. 2: A Web page in the „one company one screen“ condition.

Based on the survey results a number of different portfolios were generated (n = a minimum of 10 companies). Their performances were compared to the market.

Recognition

		high	low
Trust	high	Portfolio 1	Portfolio 3
	low	Portfolio 2	Portfolio 4

Fig. 3: Illustration of portfolio generation.

References:

- Borges, B., Goldstein, D. G., Ortmann, A. & Gigerenzer, G. (1999). Can ignorance beat the stockmarket? Name recognition as a heuristic for investing. In G. Gigerenzer, P. M. Todd & the ABC Research Group, *Simple heuristics that make us smart* (S. 59-72). New York: Oxford University Press.
- Ortmann, A., Gigerenzer, G., Borges, B. & Goldstein, D. G. (2002). The Recognition Heuristic: A Fast and Frugal Way to Investment Choice? Unpublished manuscript.
- Reips, U.-D. (2002). Standards for Internet-based experimenting. *Experimental Psychology*, 49 (4), 243-256.

Results

Results show that simple recognition by laypersons can be turned into a successful portfolio strategy in a sideways to slightly upward developing stock market. Throughout the 3 month period of examination the Stock Choice Recognition Portfolio performed better than the average of the main indices the stocks were chosen from and beat it in the end (participants in the German version by 5.9%, in the English version by 1.4%). The German version even fared better than all expert portfolios. Furthermore, low recognition performed much worse than the market. This seems to be the only situation for trust to improve a bit on recognition. Both factors are highly correlated: $r = .94, p < .001$. The impression of robustness of the Stock Choice Recognition effect is supported by the fact that it was successful in both language versions, because the respective samples are likely to have different markets of reference.

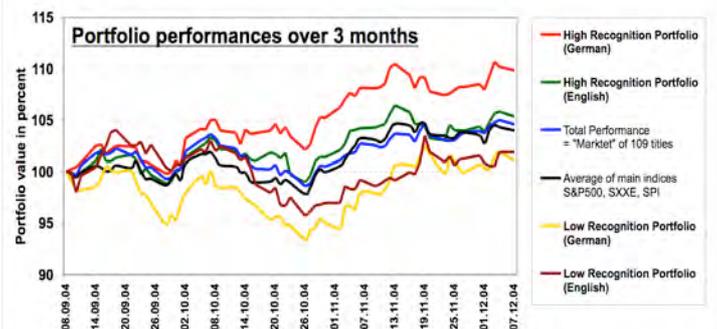


Fig. 4: Portfolio performances from Sept. 08 to Dec. 07, 2004.

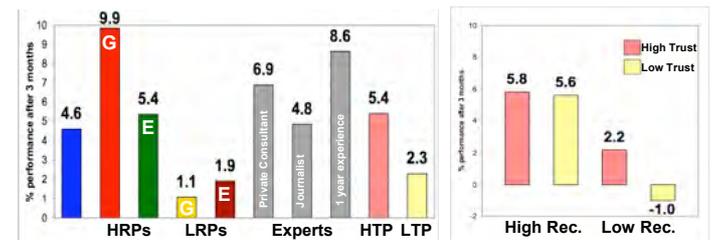


Fig. 5: End performance of portfolios in comparison to „market“ (blue). Note: HRPs = High Recognition Portfolios, LRPs = Low Recognition Portfolios, HTP = High Trust Portfolio, LTP = Low Trust Portfolio, G = German, E = English.

Fig. 6: End performance of interaction portfolios.

In a **minor result** recognition turned out to be prone for errors. Non-existing companies were sometimes „recognized“. In the German version 59% of companies were recognized, in the English version 34%. Percent recognition correlated 90% (German version) to 98% (English) with trust. Still, self-reported amount of monthly time spent with stock market only correlated as expected with recognition, but not with trust.

Answering format influenced participants' motivation to continue with the study. In this rather long study it was more motivating to see many items on one page.

Discussion

Yet again, the recognition heuristic turned out to be a successful strategy, this time in a sideways developing stock market. Other heuristics were less successful, as were the experts. Interestingly, the expert who did best was the one with the least experience.

Further investigation will be needed to look at down-market situations and the process that ties high recognition to successful stock market strategies.

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