BEHIND THE SCREEN

A FINANCE PROFESSOR FOR THE PEOPLE

Terry Odean’s new research sends a wake-up call to online investors.

I t’s been a busy season for Terry Odean. The 49-year-old recently named professor at the University of California-Davis spent September presenting his latest research to conferences at the Securities and Exchange Commission, Yale and Princeton. But his message—about why people routinely make lousy trading decisions—is even more important to average investors.

The Unifying Theme of Odean’s Work: Overconfident Investors Trade Too Often—and That Hurts Their Returns.

The unifying theme of Odean’s work in behavioral finance—an area of study that focuses on the psychology of investing—is the peril that overconfidence brings. He’s examined topics ranging from the different ways men and women invest to the performance of investment clubs, and in every case, one conclusion rings louder than all others: Overconfident investors trade excessively—and execution trading torpedoed returns. (You can read his research, both published and in progress, at www.gmu.acad.edu/~odean)

Testing that hypothesis again, Odean recently turned his attention to online investors—and the findings aren’t pretty. In a draft paper released in September, Odean (with fellow UC-Davis professor Brad Barber) investigated the behavior of 1,607 investors who moved online between 1991 and 1996. The results?

Before going online, the investors typically had superior returns, beating the market by more than two percentage points annually. But once they switched to cyberspace, they traded more actively, more speculatively and less profitably than before, lagging the market by more than three percentage points. Their returns also trailed a comparable group of offline investors. “It is like the tortoise and the hare,” says Odean. “This is a race won by the tortoise.”

Actually, one could consider Odean something of a tortoise himself. A child of the 1960s and a native of suburban St. Paul, Odean dropped out of college creative writing studies to hitchhike through Europe. The travels turned into a way of life as he wandered his way through a series of unrelated pursuits—New York City cabdriver, options trader, computer programmer, among others—for nearly two decades. “I got sidetracked,” he says. “It was more the times than anything else.”

At 37 and living in Berkeley with his wife and the first of three daughters, Odean figured it was time to finish his undergraduate degree. He planned to study psychology, but a talk with professor Daniel Kahneman, a legendary researcher on decision-making biases, prompted the number-crunch Odean to pursue his Ph.D. in behavioral finance.

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Behavioral finance was still a new discipli

age chieftain—until one firm (he won’t say which) coughed up 78,000 account records. “There hadn’t been much work in how individual investors behaved until Terry came along,” says Harsh Shethro, a professor at Santa Clara University and behavioral-finance pioneer.

But will average investors heed Odean’s warnings? He’s made at least one convert: himself. Odean invest mainly in index funds, ignoring how they’re doing except at tax time. That’s a turnabout for a man who, back in his wilder days was a test case for the mistakes of the traders he now studies. “I traded too actively, traded too speculatively and dug to my knees,” he says. “I violated all the advice I now give.” —AMY HILDMAN

amy_hildman@money.com