Behavioral Economics

Kevin Forristall, Vice President of Risk Management at TS Bank, spoke at the Treynor Optimist Club on January 12. Kevin never took a deep interest in studies until he took some psychology classes in college. They finally engaged his interest in a subject. Kevin talked about the role of psychology in business decision making.

"Do we make decisions based on our automatic inherent knowledge or on calculated decisions?" For example, a master chess player can look at a chess game and immediately assess the next move. An antique appraiser may make an immediate assessment of the value of an item even though he has not seen one like it before. A fireman can make a rapid assessment if a building is safe to enter or not.

Intuition does not always lead to the right conclusion. For example, Pepsi and Coke have had a long-running competition. In taste tests, Pepsi consistently won taste tests over Coke. However, Coke always sold better. Why. Further study determined that the difference was between drinking one ounce test case and a twelve ounce can. Coke tasted better when people drank the entire can.

Stock markets are another example of something based on emotion instead of long term potential. Markets change on a single indicator.

There is also the phenomena of hindsight bias. In hindsight, you can always be right. Hindsight bias can make you overconfident.