# Opinion: Wall Street’s testosterone problem

marketwatch.com/story/wall-streets-testosterone-problem-2017-10-17

Mark Hulbert

Invalid Date


Wall Street has a testosterone problem. No, I’m not going to reveal who on Wall Street is guilty of behavior similar to what’s alleged of Hollywood’s Harvey Weinstein.

I instead have in mind a different kind of testosterone problem: Overconfidence and hubris, which leads traders into self-destructive investment behavior.

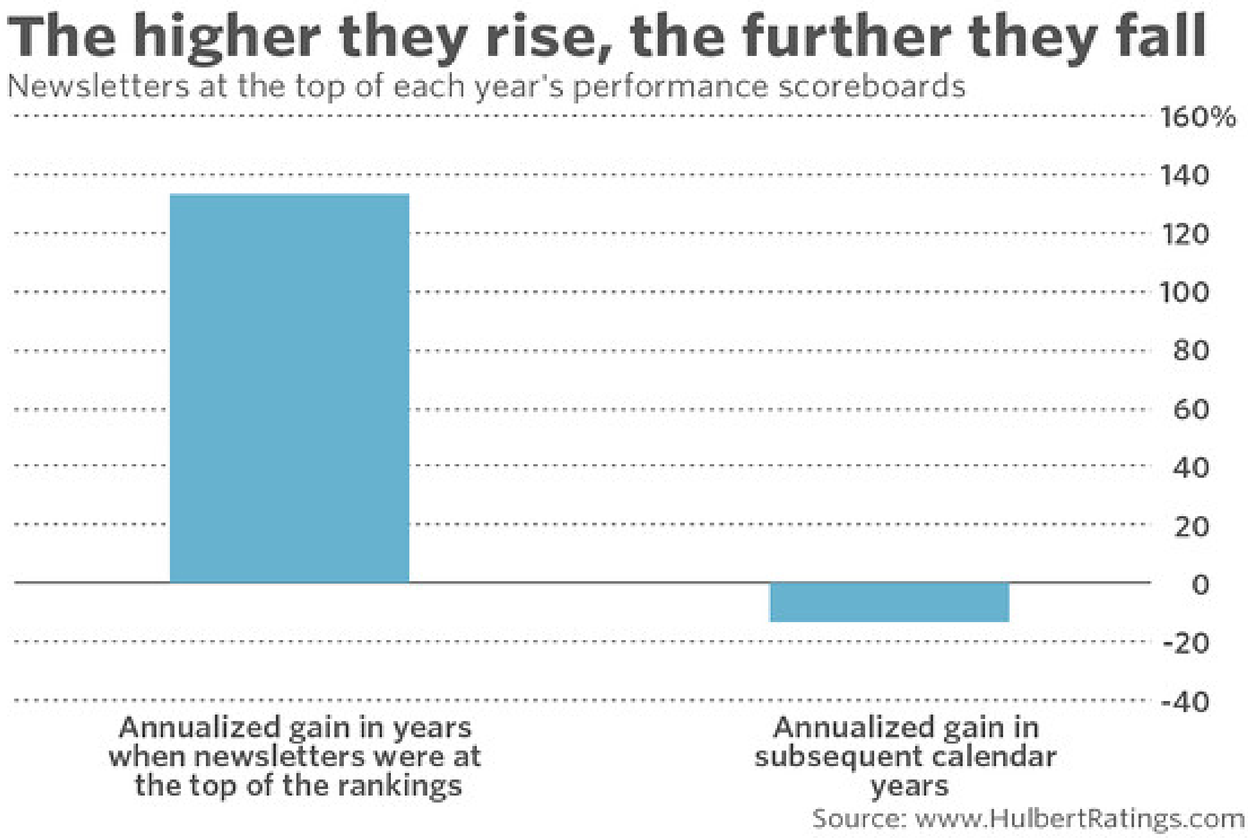
It’s hardly a surprise that overconfidence and hubris are widespread on Wall Street, of course. But linking those behavioral characteristics to testosterone has not been studied before.

A new double-blind study of male traders documents just such a link. It was conducted by Amos Nadler of the University of Western Ontario, Peiran Jiao of the University of Oxford, Paul Zak and Veronika Alexander of the Center for Neuroeconomics Studies at Claremont Graduate University, and Cameron Johnson at the Behavioral Health Institute at Loma Linda.

The researchers divided the traders into two groups, with one receiving testosterone and the other getting a placebo. The authors then carefully analyzed the two groups’ subsequent trading behavior. They found that the traders who received testosterone increased the frequency of their trading and were more willing to pay a higher price for stocks they liked. The researchers noted that while the placebo group were more contrarian, attempting to buy low and sell high, the testosterone group’s trading behavior was motivated by a “buy high, sell higher” mentality.

In addition, in trading simulations that the researchers conducted, the testosterone group’s trading led to more and bigger price bubbles than did the placebo group’s, and mispricing persisted longer.

What accounts for these results? The researchers found that the testosterone-boosted traders were more likely to attribute gains to their skill than to luck, and that their resultant overconfidence led them to riskier behaviors. If those behaviors in turn worked out, the traders became even more confident in their abilities and willing to incur even more risk. The longer this reinforcing feedback cycle continued, the bigger the losses when the traders' luck turned.




To test for the presence of this feedback cycle, I analyzed my four decades' worth of investment newsletter returns. I focused in particular on those newsletters that were at the top of each calendar year's performance scoreboards — often with triple digit gains and sometimes even with profits in the thousands of percent.

Guess how the editors of these top performers reacted to their huge profits. Do you think they realized that the odds were next to zero that they could ever turn in such performance again, and therefore took their profits out of the market and put them instead into the bank?

Of course not.

The Future of: Smart Cities

Consider how awful the typical top performer did in the year after he was at the top of the performance rankings. In contrast to an average gain of 133.5% in the years when these newsletters were at the top of the leaderboard (calculated over the last two decades), their average gain in the subsequent calendar year was a loss of 13.4% annualized.

In other words, success went to their heads.

Is there a way to counteract this testosterone-inducted behavior? Professor Nadler says yes: "Perhaps the simplest recommendation is to implement 'cool down' periods to interrupt exceptionally positive feedback cycles and return the focus to assets' fundamental valuations to reduce the possibility of biased decision-making."

His recommendation is geared to professional traders employed by firms that can impose such cool down periods. But the rest of us can adopt the functional equivalent: If we make a lot of money, then go take a cold shower.