

## IV. Mental Compartments

- Shefrin & Thaler: Compartments: current wage, asset, and future
- Shefrin & Statman: Investors have a “safe” part of their portfolio that they will not risk, and a “risky” part of their portfolio that they can have fun with
- Option salespeople use these tactics: buy a put option on a single stock

## V. Attention Anomalies

- Attention is fundamental aspect of human intelligence and its limits
- Social basis for attention
- Inability to account for one's attention
- “No arbitrage assumption” of financial theory: No ten-dollar bills lying around. Does not require everyone is paying attention

## VI. Anchoring

- Kahneman & Tversky wheel of fortune experiment
- Subjects unaware of their own anchoring behavior
- Examples: stock prices anchored to past values, or to other stock prices in same country. Do splits to keep at \$30
- CSW Inc. to be changed to CSW.com?

## VII. Representativeness Heuristic

- People judge by similarity to familiar types, without regard to base rate probabilities (sensitive, artistic woman, sculptress or bank teller)
- Tendency to see patterns in what is really random walk
- Stock price manipulators try to create patterns to fool investors. Short a stock and create a head & shoulders

## VIII. Disjunction Effect

- Inability to make a decision that is contingent on future information
- Shafir & Tversky: People who took one of Samuelson's lunch colleague bet (flip a coin: heads you win \$200, tails you lose \$100) were asked if they would take another. Most took the second bet whether or not they won the first. But most would not take second bet before outcome of first was known
- Reaction of stock market to news, Make stock strategies to trade on news