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Our Spring 1997 issue leads off with Arnold Wood's article on behavioral risk. Looking at the psychological issues that underlie investments represents the latest research frontier. Brian remembers taking a decision theory class ten years ago at the University of Chicago, and thinking that many of the decision errors described were applicable to the stock market. At the time, no one was interested in applying this research to the investment field. Now, it has become the hottest approach.

Errors in judgment include over- and underestimation as well as inability to assess probabilities properly. These judgment flaws become very clear when Brian's investment students are given a quiz every year. They must estimate a range that an answer should fall between, with nine of ten answers correct. Examples are "how many books are there in the Bible?" and "how many people signed the Declaration of Independence?" The answers are absolute numbers, and small enough that a guess like zero to 250 would easily be right, but making sure that the estimation is close enough that nine out of ten are correct proves incredibly difficult.

This past semester 100 MBA students took this quiz. The average number correct was three. The highest was eight. Not one student hit the goal. Taking advantage of this type of systematic flaw in judgment is the essence of new research in behavioral finance.

David Dreman and Arnold Wood have led the effort to bring psychologists and investors together. We are pleased that Arnold has shared his insights with our readers.

Brian R. Bruce
Editor-in-Chief

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Executive Editor