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## Finance prof's research provides insight for small investors

WEST LAFAYETTE, Ind. – While Purdue University's Laura Frieder is interested in what makes financial markets move, her research also contains insights on common mistakes individual investors make in choosing stocks.

Frieder, a [Krannert School of Management](#) assistant professor of finance, is currently doing research on stock market returns following earnings announcements and also has studied market reactions around holidays, as well as how brand perceptions influence returns.

In her earnings announcement study, she explores earnings "surprises," the announcements of quarterly company earnings that come in above stock analysts' predictions. She found that small investors, in particular, tend to be influenced to buy a stock if it has delivered a string of positive earnings surprises. The stocks that tend to be purchased so aggressively usually do not do well subsequently.

"It's similar to betting on roulette in Las Vegas," Frieder says. "Just because red has come up six times in a row doesn't mean it's going to come up on the seventh."

In their study on stock trading around holidays, Frieder and co-author Avaniidhar Subrahmanyam from UCLA look at the behavior of returns and volume on trading days that fall on religious and cultural days, specifically St. Patrick's Day, Rosh Hashanah and Yom Kippur. What they find is that "mood-based explanations can form an avenue for explaining market movements."

The festive nature of St. Patrick's Day and Rosh Hashanah leads investors to buy in the days preceding the days of celebration. And, they write: "We find significantly negative returns after Yom Kippur in the second half of our sample period, which accords with the idea that the market reflects the solemn nature of this occasion."

Frieder and Subrahmanyam take up another tendency of small investors in their brand-perception study. Individual investors tend to invest in stocks with well-known brands and products. Mutual funds and large professional investors, on the other hand, tend to hold

large-firm stocks which are less volatile, meaning their share prices don't go up as much or down as much as the overall stock market. In investor parlance, this low volatility is referred to as a "low beta."

Frieder says individual investors should depend less on impressions and emotion and do more homework so they buy solid companies with good earnings prospects and solid management. That means reading a book or two on long-term investing, learning to decipher companies' financial reports, matching investment risk to the investor's goals and avoiding chasing today's hot stock, sector or industry.

There are other common investor mistakes that Frieder says are even easier to avoid:

- Don't trade too much, she says. "Even with cheap online trading available, individual investors need to manage their trading costs. The more trades you make, the more it lowers your overall return."
- Beware of online scams. "I am doing some research with Jonathan Zittrain, a professor of law at Harvard, and preliminary results indicate that volume can triple on stocks that are recommended via randomly spammed mass e-mail."
- Don't become emotionally attached to individual stocks. "This is an old investment saw, but my research results corroborate it," Frieder says. "The idea that individuals hold on to loser stocks has been well-established before me, but I still think it is a big one."

For all the mistakes of individual investors, Frieder says she admires their spirit and pluck. But she still points out the oft-repeated No. 1 rule to beat the market pros: Buy a low-fee index mutual fund, a large basket of stocks available from the big mutual fund companies that tracks the whole market and whose returns regularly beat actively managed, higher-fee funds. Then, contribute regularly and check the fund price once a year.

**Note to journalists:** An electronic copy of Laura Frieder's research is available by contacting Mike Lillich, (765) 494-2077, mlillich@purdue.edu.

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