Martha Stewart's Lessons in Behavioral Finance

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Meir Statman (https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=143350)
Santa Clara University - Department of Finance

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Abstract

Martha Stewart taught us how to set a dinner table, decorate a cake, and make a Christmas wreath. She never meant to teach us about investments, but she did. The portfolio that Martha Stewart revealed to prosecutors and the jury at her trial is a portfolio of a normal investor, containing both winners and losers, and the investment behavior she revealed is normal behavior, affected by cognitive biases and emotions. Martha Stewart's portfolio and her investment behavior offer lessons that financial advisers can use to guide their clients to better portfolios and better behavior.

Financial advisers can use the story of Ms. Stewart to assure their clients that even very rich and prominent people are subject to cognitive biases and emotions. They can use the story to make their clients aware of their own common cognitive biases and emotions. For example, financial advisers can share with clients brief descriptions and examples of cognitive biases and emotions. Awareness is the first step, but it is not always sufficient. Financial advisers can follow up with rules that help clients overcome their cognitive biases and emotions. For example, a rule that mandates "loss harvesting" at the end of every quarter makes realizing losses easier because it becomes automatic.

The work of financial advisers is never easy. Too many investors are slow to learn and quick to forget. Too many investors are quick to complain and slow to thank. Financial advisers cannot turn normal investors into rational ones any more than Martha Stewart can turn normal people into perfect hosts. But financial advisers can turn normal investors into smart investors.

Keywords: Martha Stewart, Investor Behavior, Cognitive Biases, Emotion, DIsposition Effect

JEL Classification: G11, G14

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