

Heard Mentality

By ARSamson

Many investors get their news secondhand, by hearing about it. Seldom do they bother to read the papers or switch to Bloomberg (at least to mouth the clichés). And even then, media often present stories based on unconfirmed reports and anonymous sources.

This “aural tradition” of keeping up to date feeds into our penchant for conspiracy theories. Anybody at a party can concoct a scenario; say on the impact of the World Bank suspension of the road contract loan, on the credit rating of the country. There is no need to specify the source of the rumors or cite the basis of the scenario moving forward. Think of the possibilities of even a failed six-hour coup at a hotel lobby and the speculations on the aftermath.

We need only follow the information pipeline of a listed company to see how hearsay easily substitutes for reality. The company itself may promote a certain “story line”—maybe it is about growth premised on acquisitions, a diversification story to move away from a declining core business, a consolidation theme with headcount being reduced and divisions closed or sold.

The dominant theme is communicated to research analysts and investors through the Investor Relations of the company concerned. The research findings may then rate the company as a “buy”, “hold”, “buy on weakness”, or “sell”. There may be other intermediary ratings (don’t touch it with your children’s tuition money) which the research departments give their clients.

The information chain does not end here as the heard mentality kicks in. Without delving into or even understanding the details of the research and the caveats on the underlying assumptions, intermediaries will pass on to other bit players their flawed interpretation of the findings.

The “hearsay effect” is particularly fertile in new listings as in recent IPO’s. One has yet to meet anyone who has completely read the prospectus on the new listings. The simple question of what the equity float will be used for (to open a new plant or just make existing stockholders richer?) and the PE ratios obtaining have led to short-lived up-ticks of new listings. This is followed by low volume and languishing prices. While hype is frowned upon, the admonition by regulators is limited to the unread prospectus. Hearsay is not covered by any rules, and can propound undocumented claims of how the pre-listing price is doing (clue: it is *not* lower than the IPO price).

Legitimate research organizations disclose the assumptions for their recommendations. They can even question official projections of next year’s revenues used as basis for the PE ratios justifying the IPO price.

The routine use of intermediaries in disseminating news is no different from how social intercourse is conducted. Thus, an old-fashioned courtship relies on a cousin or best friend to get information on and entry into the heart of the intended. Influence peddling is but another variant of the intermediary route, although this is seldom on a pro bono basis. Mistresses and assorted relatives are routinely used to gain access to favors and audiences.

Barbara Tuchmann, the historian (“The Guns of August”, “Distant Mirror”) says that hers is an exacting discipline. In her essay on history, she espouses the importance of documentation rather than rumor in establishing her narrative interpretation of historical events. Even the weather which provides the setting for a battle or a diplomatic meeting is not flimsily established. More than one eyewitness account is used, and preferably, actual meteorological documents.

The problem with relying on aural information lies with the reliability and objectivity of the source and more important, an appropriate context for his conclusions.

It is no accident then that business reporting suffers from a form of hearing impairment. Because media themselves often suffer from economic illiteracy, reports on financial performance ignore accounting reports altogether. Instead, the more accessible and easily understood (and heard) parts of a business story tend to be highlighted. These are the human angles of rivalry and falls from power, cadged from ambush interviews after the formal report to stockholders and investors.

The aural sect is not limited to the local scene. Even international hedge funds and large equity ventures follow their own herds. Preferred economies are lumped in acronymic hit lists like BRIC (Brazil, Russia, India, and China). Now and then, we get into the abbreviated destination list under TIP (Thailand, Indonesia, Philippines).

It is easy to test this theory of the heard mentality. One only has to list down the news of the day he has gathered. He can then check his source. They will easily fall into the following categories: 1) It was a topic in a breakfast meeting where somebody overheard something significant; 2) It was heard on the radio with the commentator having strong feelings about it, pounding the table a number of times; or 3) It was Topic A at the gym from somebody’s personal trainer.

Even if one has actually read the morning papers, most of what he finds there is not based on documentary sources. The authority cited is unnamed, with a quote not made for attribution (a person close to this official said...). Even then, reading habits indicate that most people only read headlines and maybe the first few paragraphs of the story. Seldom do they chase the details into the jump pages.

And how do they fill in the missing details? They wait for somebody to tell them. Thus even if a story is still making the front pages, if no one talks about it, it might as well be dead. (Is anyone still talking about the blast at the mall or how supermarket bags are recycled for other uses?)

In checking if a story is true, most are content with the ultimate test for accuracy—“That’s what I heard”. Strange as it may seem, many are willing to put their money on a stock which they heard is going to double in two weeks. This information is then passed on...making sure they buy the stock first.