

KIM: NFL Draft reveals behavioral finance truths

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Financial journalist Gary Belsky recently wrote “The Overconfident Investor” in The New York Times, which explored cognitive biases and shortcuts that plague investors.

According to Belsky, the study of behavioral finance blossomed because securities markets provide researchers with billions of data points for analyzing “judgment under uncertainty” and “decision under risk.” This data enables researchers to understand how people make choices when “resources are at stake” and “the outcome is unknown.”

He was referring to investors, but could have been talking about NFL general managers. With the Los Angeles Rams and Tennessee Titans announcing a blockbuster trade of picks in the upcoming draft, this is a good time to revisit one of my favorite column topics.

The Rams, desperate to make a splash as they return from St. Louis, acquired the No. 1 overall pick in the 2016 Draft from the Titans (along with the Titans’ 4th (#113) and 6th round (#177) picks). In return, the Titans received the Rams’ 1st-round pick (#15), both 2nd round picks (#43 and #45) and 3rd round pick (#76). In addition, the Titans received the Rams’ 1st and 3rd round picks in next year’s draft.

The Rams hope to select a “franchise” quarterback, presumably Carson Wentz of North Dakota State or Jared Goff of California. The Titans now control six of this draft’s first 76 picks and will have five picks in the top three rounds of next year’s draft. Watch out, AFC South.

Belsky listed five harmful traits.

Overconfidence and Optimism Bias refer to our tendency to overrate our abilities, knowledge and skill, whether it’s picking stocks or evaluating a player’s NFL potential. Together, they are “part of a suite of cognitive traits that serve to propel us forward.” While necessary for success, they can give us a false sense of security.

Hindsight Bias describes our tendency to “rewrite our own history to make ourselves look good,” which makes it hard to learn from past mistakes.

Attribution Bias refers to how we attribute happy outcomes to our skills, knowledge or intuition, but blame outside forces for bad outcomes.

Confirmation Bias “leads us to give too much weight to information that supports existing beliefs and discount that which does not.”

Ironically, the Rams were the beneficiary of one of the most lopsided trades in draft history. In 2012, the Washington Redskins thought Robert Griffin III was their “can’t miss” franchise quarterback. In order to move up to the Rams’ #2 spot, Washington surrendered the #6 and #39 picks in 2012, plus their 1st round picks in 2013 (#22) and 2014 (#2).

Griffin was injured late in his stellar rookie season and recently released.

Hoosier natives Tobias Moskowitz, finance professor at the University of Chicago, and Sports Illustrated senior writer Jon Wertheim wrote Scorecasting: The Hidden Influences Behind How Sports Are Played and Games Are Won. Their goal was to challenge sports truisms through rigorous statistical study and convey their results in an entertaining, thought-provoking way.

They found the NFL Draft to be rife with false beliefs and destructive decision-making. Specifically, teams consistently place excessive value on high draft picks and routinely overpay, in terms of current and future picks, to move up.

Investors and NFL general managers overestimate their ability to pick winners and underestimate the role of luck. Scorecasting suggests teams with a top pick consider trading it for multiple lower picks from a team desperate to move up. The more picks you have, the better chance you have to get lucky.

Picking franchise quarterbacks and stocks are difficult. Since 1990, the following quarterbacks were drafted by teams trading up to a Top-5 pick: Jeff George, Ryan Leaf, Michael Vick, Mark Sanchez and Griffin. None will be in the Hall of Fame. Mutual fund stalwart Sequoia Fund had a huge 30% position in Valeant Pharmaceuticals, leading to disastrous performance and resignation of its star manager.

Investors and NFL general managers must overcome their cognitive biases to succeed.

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