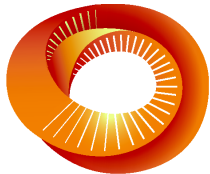


# PROGRESS IN SOCIONOMICS

A publication of the Socionomics Institute

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**SOCIONOMICS**  
INSTITUTE

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## LETTER FROM THE EDITOR

We are happy to report on two academic papers incorporating aspects of socionomics. Last year the *Journal of Behavioral Finance (JBF)* published Washington State University Associate Professor John Nofsinger's "Social Mood and Financial Economics." This year the *JBF* plans to publish Kenneth Olson's "A Literature Review of Social Mood." Olson is a professor of psychology at Fort Hays State University in Kansas. These are the first socionomics-related papers penned by academics outside the Institute and Foundation. You may purchase subscriptions to the *JBF* through the publisher, at [www.erlbaum.com](http://www.erlbaum.com). Back issues are also available. We recommend this journal for anyone interested in the psychology of financial markets.

This year will also bring the release of a one-hour documentary on socionomics, *History's Hidden Engine*, by award-winning filmmaker David Moore. Beginning on March 31, the Institute will make the entire documentary available free via online stream or download from our website at [www.socionomics.net](http://www.socionomics.net). The documentary is Volume 1 of the developing Socionomics Film Series. Volume 2 in the Series, *Broader Discussions of Socionomics*, includes nearly 90 minutes of extended interviews with experts on socionomics. For information, just visit [www.socionomics.net](http://www.socionomics.net).

As far as we know, this is the first time a major documentary has been released on the internet. We think it's fitting that a theory with broad potential application be disseminated via a disintermediated

channel. Be sure to read our interview with Moore regarding his post-production thoughts on the documentary on page 5.

This issue of *Progress In Socionomics* has several additional features. Dr. Wayne Parker of the Socionomics Foundation highlights recent research in the field of neuroscience that may lead to evidence supporting the socionomic hypothesis. We reprint an excerpt on socionomics from U.K. author Tom Slator's 2005 book, *Britain's Debt Crisis*. John Rogelstad, whose company manufactures textiles in the U.S., comments on how he is applying socionomics in his business strategy. And Michael Flagg, a student of nuclear engineering, looks at the theory of "Peak Oil" from a socionomic perspective.

The year 2006 promises to be a big one for socionomists. We're glad you're along for the ride.

Gordon Graham  
Director, Socionomics Institute

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## **UPCOMING EVENTS**

### **Robert R. Prechter, Jr.**

*Socionomics Institute*

*The Kenos Circle: Oil Puzzle Conference*

March 16-17, 2006

Vienna, Austria

[www.kenos.at/html/Puzzel.htm](http://www.kenos.at/html/Puzzel.htm)

### **Michael K. Green, Ph.D.**

*SUNY Oneonta*

*Western Social Science Association 48th Annual Conference*

April 19 - 22, 2006

Phoenix, Arizona

Wyndham Phoenix

### **Wayne D. Parker, Ph.D.**

*Socionomics Foundation*

*IAREP/SABE Congress*

*Congress of the International Association for Research in Economic Psychology (IAREP) and The Society for the Advancement of Behavioral Economics (SABE)*

July 5-8, 2006

Paris, France

Headline speakers at the conference include Daniel Kahneman and Antonio Damasio. From the description of the proposed session for which Dr. Parker has been invited to present a paper: "The analysis of these issues requires a highly interdisciplinary approach (psychology, evolutionary biology, neuroscience, and the new approach to social interaction called socionomics are all involved) and a cautious methodological discussion." More information about the IAREP/SABE conference is available at <http://team.univ-paris1.fr/iarep-sabe2006/>

## **RECENT ACTIVITIES**

### **Robert R. Prechter, Jr.**

*SUNY at Plattsburgh*

Thursday, November 3, 2005

Plattsburgh, New York

Presentation title: "The Socionomic Model of Financial and Social Causality"

*Golden Gate University*

Wednesday, December 14<sup>th</sup>, 2005

San Francisco, California

Presentation title: "The Socionomic Model of Financial and Social Causality"

*CSTA Montreal Annual Conference*

Saturday, October 15, 2005

Marriott Château Champlain

Montreal, Quebec

Presentation title: "The Socionomic Model of Financial and Social Causality"

### **Michael K. Green, Ph.D.**

*Northeast Popular Culture/American Culture*

*Association 28<sup>th</sup> Annual Conference*

October 28-29, 2005

Sacred Heart University, Fairfield, CT

### **Socionomics Forum at SUNY Plattsburgh**

On November 3, 2005, Robert Prechter delivered a presentation titled "The Socionomic Model of Financial and Social Causality" at SUNY at Plattsburgh. The sponsors graciously organized a forum the following day to discuss socionomics in an informal, open setting. Dr. Wayne Parker (Socionomics Foundation), Dr. Michael Green (SUNY College at Oneonta), Pete Kendall (Elliott Wave International) and Gordon Graham (Socionomics Institute) all participated. The forum attracted faculty members representing economics, sociology, education and history as well as students and the public who had attended Prechter's presentation the evening before. Participants engaged in a highly spirited discussion centering on two of the hypotheses of socionomics: (1) the deterministic character of aggregate behavior, and (2) the fact that social mood causes social action, not the reverse.

Initially, many participants found the socionomic view of causality novel to the point of disbelief. By the end of the forum, however, a few of those same faculty asked questions and sought more discussion with the presenters. The Socionomics Institute is planning visits to more campuses for the future. Please contact the Institute if you are a faculty member and would like to open a similar forum at your university.

## **Knutson's Study, "The Neural Basis of Financial Risk-Taking," Sheds Light on Socionomic Theory**

Wayne D. Parker, Ph.D., Executive Director,  
Socionomics Foundation

Dr. Brian Knutson, an experimental psychologist and neuroscientist at Stanford University, has conducted some exciting research that may point the way toward neurological evidence for key elements of socionomic theory. Knutson is one of the leaders in the fields of neuroeconomics and neurofinance, areas of science that apply research findings in neurology to help understand better the workings of economic and financial behavior. He has been coming up with breakthrough studies in these fields over the past decade and recently examined the neural correlates of financial risk-taking. His collaborator was Camelia Kuhnen, a doctoral candidate in finance at Stanford's business school and a former research assistant for MIT's Andrew Lo, also a leading finance researcher. Kuhnen and Knutson's recent fMRI study, published last September in *Neuron*, explored the neural basis for the finding by behavioral finance researchers that investors are not always 100% rational in their decision-making. They looked at whether anticipatory neural activity would predict investing mistakes in a laboratory simulation of financial decision-making.

Kuhnen and Knutson created a research design enabling them to separate the neural correlates of both "risk-seeking mistakes" and "risk-aversion mistakes," where subjects' affective biases led them to take either more risk or less risk than would be optimal. If you are an active trader in the financial markets, you have probably experienced these kinds of mistakes occasionally in your own trading. Adam Levy, an Atlanta-based reporter for Bloomberg News, interviewed Knutson for a recent article reviewing cutting-edge developments in neurofinance. Levy reported, "Subjects who showed high activity in the anterior insula [AI] were 20 percent less likely to invest in a stock that had lost money before, even when the odds were good that they would profit. Such people might sell impulsively when markets turn against them, Knutson says."

In contrast to the AI, which seems to be one of the brain's centers for negative feelings like anxiety, Knutson also focused in his study on the "pleasure center" of the brain, the nucleus accumbens (NAcc). Knutson's research, said Levy,

shows that "The pleasure of orgasm, the high from cocaine, the rush of buying Google Inc. at \$450 a share – the same neural network governs all three."

As Knutson explored the role of affect in the brain during financial decisions, his theory was that positive feelings associated with anticipating gains (excitement) promote risk-taking, while negative feelings associated with anticipating losses (anxiety) promote risk-aversion. This basic idea is very similar to a hypothesis from socionomics that positive mood leads to more buying in the stock market and negative mood leads to more selling. Knutson studied the activation of the NAcc (for positive affect) and AI (for negative affect) using functional magnetic resonance imaging (fMRI) techniques. The goals of his study were (1) to see whether anticipatory activity in these areas would predict risk-seeking vs. risk-averse choices, and then (2) to examine whether activation in these areas would predict both suboptimal and optimal choices.

Knutson's study makes a major contribution to financial research literature through the invention of a clever research tool called the Behavioral Investment Allocation Strategy (BIAS) task. With the BIAS task, subjects see two stocks and a bond, then choose one to "invest" in. Uncertain pay-offs for both stocks are built in (one is a "good" stock that pays off better than the "bad" stock), while the bond has a predictable but boringly low pay-off. Knutson predicted that gain outcomes would activate the NAcc and the mesial prefrontal cortex (MPFC), an area he had explored in earlier studies, and that loss outcomes would instead activate the AI.

What did he find? As predicted, gain outcomes in the BIAS task were correlated with both NAcc and MPFC activation. Also as predicted, loss outcomes were associated with AI activation. Kuhnen and Knutson also found that *anticipatory* NAcc and AI activation were correlated with *subsequent choice*, and these associations were critically dependent on prior choice. High NAcc activation predicted switching to risk-seeking choices after choosing a bond, while high AI activation predicted switching to risk-averse choices after choosing a stock.

Interestingly, MPFC activation was not correlated with subsequent mistakes. In this area, anticipatory neural activation correlated with both optimal and suboptimal subsequent choices. This was true even after controlling for behavioral

variables (including earnings of different stocks, cumulative earnings, uncertainty levels of pay-offs, prior choice, prior outcome) that should have been the primary determinants of those choices if the investors were making decisions on the basis of rational logic alone. Knutson interprets these findings to mean that the MPFC has a “role in representing gain prediction error rather than gain prediction.”

Knutson found considerable individual differences in AI activation, and also found that these individual differences in average AI activation during anticipation were significantly correlated with the frequency of risk-aversion mistakes. In other words, some investors are more anxious than others, and the overly anxious ones are so intent on avoiding losses that they make costly investing mistakes.

Overall, Kuhnen and Knutson found that anticipatory neural activation can be both a blessing and a curse: Sometimes such activation contributes to rational choices that lead to investing success, but at times it may also promote irrational choices that cost you money. Thus, these researchers conclude, “financial decision making may require a delicate balance – recruitment of distinct circuits may be necessary for taking or avoiding risks, but excessive activation of one mechanism or the other may lead to mistakes.”

So how is this study related to socioeconomic theory? It is relevant for us in a number of ways. For one thing, this study is important new evidence that mental predisposition matters to financial decision-making. Kuhnen and Knutson note in their paper, “theories that fail to include the anticipated subjective value of an outcome cannot easily account for the observed pattern of results.” This at least leaves the door open to the socioeconomic theory that, at the aggregate level, endogenously regulated dispositions toward optimism or pessimism produce subjectively anticipated values, upon which people base buy and sell decisions (and many other decisions, as well). What is optimism if not positively valenced affective expectation of gain? And what is pessimism if not negatively valenced affective expectation of loss? The anticipation of gains or losses explored in Knutson’s study is thus directly related to what socioeconomic theory calls “positive mood” and “negative mood,” respectively.

In a paper that we are preparing on the neurophysiology of mood as related to socioeconomic theory, we plan to draw on the results of Knutson’s research and others. Careful neurophysiological research such as Kuhnen and Knutson’s may help provide the empirical base of evidence for our socioeconomic conceptualization of mood, and for how such affective processes are embodied in the brain.

*You can help make it possible for the Socionomics Foundation to conduct the neurophysiological research necessary to establish the neural correlates of unconscious mood and other key aspects of socioeconomic theory. Please consider making a tax-deductible donation. For more information, visit [www.socionomics.org](http://www.socionomics.org). Thank you!*

### **Making History: An Interview with Film Director David Edmond Moore**

*David Edmond Moore of Eyekiss Films in Atlanta recently completed a documentary on socioeconomics titled History’s Hidden Engine, which on March 31<sup>st</sup> will become freely available for viewing or download at [www.socionomics.net](http://www.socionomics.net). We interviewed David on his thoughts post-production:*

#### **Q: What inspired you to create a documentary on socioeconomics?**

**A:** I first became interested in socioeconomics after reading Bob Prechter’s report, “Popular Culture and The Stock Market.” It was the first time I had heard of the Wave Principle. I found it remarkable that the stock market correlated with trends in fashion, movies and music. I wasn’t really a finance guy. I was just out of school, and pop culture was what interested me. What drove it home for me was that after reading the report I noticed a correlation between the crash in 1987 and a change in the music of U2 and R.E.M. Both groups went from being just rock bands to releasing two very political albums in 87. Later still, after the market recovered from the 87 crash and we extended the massive bull market through the late 80s and 90s, U2 and R.E.M. released “happy” albums. U2 went so far as to call their album *Pop*. You can’t say it any clearer.

It was only later that I found out about the true breadth of the Wave Principle—that it doesn’t stop with the markets or even pop culture, but correlates to politics, the economy and—most exciting—biology and psychology. To think that

U2 releasing an album called *Pop* coincident with one of the strongest, positive times in our society could have primal underpinnings was amazing to me.

The more I read Prechter's work, the more I realized that visuals would really drive socio-economic ideas home. So a documentary was the obvious route.

**Q: What were your greatest challenges in producing the film?**

**A:** I could talk for a month about that topic! It was the first documentary I've made, so that was the first challenge. I had had some success in short fictional narratives and on-demand work, so at first I applied the same approaches to the documentary, and they didn't work. I had to wrap my head around what a documentary is. I realized that documentaries aren't all the same, that there is a variety of approaches. The one thing I *didn't* want to do is make a film in the style of Michael Moore—you know, inserting my ideas and opinions into the documentary, as opposed to staying behind the scenes. Also, I knew that the ideas behind socio-economics were too new and complex to explore every aspect and create a debate on film. I decided to create a piece that laid out the basic ideas with plenty of examples in a very accessible form. My hope is that this will then start the debate, and these ideas will be thoroughly examined, so socio-economics can move to the next stage toward becoming a science.

**Q: What intrigues you most about socio-economics?**

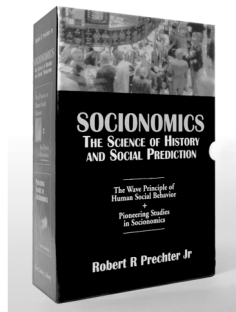
**A:** The most important thing is its potential to change the way we look at the world. It is obvious that initiative in creation, exploration and knowledge are driving forces of humankind. The quality ideas that Prechter and the others at the Socionomics Institute have put forth help further these pursuits. How could adding to these areas not be exciting? It's like an archeologist unearthing an ancient artifact and then hypothesizing about the role it once played in the world. I've always thought the Wave Principle and socio-economics had this type of parallel, just in a more philosophical way.

Also, it's cool to be part of an early science and help the ideas develop. I feel like I'm a part of something still uniquely underground and thriving, like discovering a great new movie or

band before anyone else. I don't mean that in a pretentious way. I mean that whenever you discover something new that you are interested in, it reshapes the way you think, and who you are in general. Socionomics—its whole design—reshapes the way you think.

On March 31<sup>st</sup>, History's Hidden Engine will become freely available for online streaming or download at [www.socionomics.net](http://www.socionomics.net).

**Robert Prechter's Revolutionary Two-Volume Set**



**Socionomics: The Science of History and Social Prediction** spells out a historical correlation between patterned shifts in social mood and their most sensitive register, the stock market. It also presents engaging essays – representing over 20 years worth of research – correlating social mood trends to music, sports, corporate culture, peace, war and macroeconomic trends.

[www.socionomics.net/books/books\\_home.aspx](http://www.socionomics.net/books/books_home.aspx)

**LETTERS TO THE EDITOR**

**A Socio-economic View of Offshore Outsourcing from a U.S. Textiles Manufacturer**

**John Rogelstad** is the Director of Operations for The Marena Group, Inc., a manufacturer of post-surgical garments whose main market is the cosmetic surgery industry. Recently he shared some thoughts with us regarding how he is attempting to apply socio-economics in his business strategy.

My first exposure to socio-economics was Elliott Wave International's publications, including *Conquer the Crash*, *The Elliott Wave Theorist* and *The Wave Principle of Human Social Behavior* (HSB). After reading HSB, I was convinced that the idea had basic merit and deserved consideration and exploration, especially for those of us in the business world who are on the front lines of shifts in social mood.

Since then, I have thought extensively about the implications for our business. As far as the cosmetic surgery business goes, I imagine it is

likely that the practice of spending *outrageous fortunes* on nip and tuck operations could be reaching a crescendo. Prechter noted 20 years ago that when people are in an optimistic mood they make efforts to improve themselves through active, high-energy programs like exercise.

Fitness centers have become a standard feature of the American landscape and almost anybody you talk to has spent several hundred dollars on a membership at one of these businesses in some past or present effort to “get in shape.” Yet 30 years ago, most Americans would not even have known what a fitness center was or where to find one. Today, the pursuit of perfection through cosmetic surgery seems to be the last gasp in the “self-improvement” movement. (Note how the onset of the bear market in 2000 brought with it an element of the grotesque, as illuminated by the show *Nip and Tuck*.)

To prepare for a decline in the number of cosmetic surgery operations we’re making a big effort to introduce a line of make-to-order consumer “shapewear.” The consumer market is much larger than our current niche market, so even a declining consumer market would be a “bigger pond” for us. Direct sales from the manufacturer to the consumer will be as revolutionary a deflationary force as the elimination of the wholesaler and distributor were to retail a generation ago.

As for cutting and sewing, I think we are “topping out” on the current wave of outsourcing. Right now, it is widely accepted that the only economically viable way to produce consumer goods is in distant, low-wage countries. However, as it turns out, that is not true. For example, Dell is still opening computer assembly plants in the U.S. and operating profitably. Most people don’t realize that 70 to 90 percent of the cost of clothing is in marketing and distribution. But you don’t change those costs when you make a garment domestically. The easiest way to cut costs is through distribution, not labor.

History has shown that in previous downturns, manufacturers caught with illiquid inventory suffered the most. You want as much free cash as possible in that situation. Here’s an important application of socionomics: Considering that 98% of apparel is currently made offshore, we may have a notable advantage, if we are one of the only domestic manufacturers in town, and there is a serious protectionist backlash. Others’ supply chains will break down but we’ve designed

our plans to be flexible and to work even if the current primary upswing in social mood continues. Unlike most businesses, we are keeping both possibilities in mind when crafting our strategy.

Socionomics and additional research have taught me that although current wisdom says that certain approaches, like offshore outsourcing, are the only profitable method to obtain manufactured goods, this is not necessarily true. Most major retailers have built their models in a way such that offshore supply *is* the only viable option for them, but there are other ways to build a business if one has the insight and fortitude to look in the direction opposite of the crowd. We are convinced that we can continue to manufacture goods profitably for our current industry and also build a viable domestic production model for other consumer markets even if the U.S. resorts to protectionism as Prechter expects.

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### “Peak Oil” Argument At A Peak?

**Michael Flagg** worked in the investment industry as a computer programmer for 6 years, and in May will earn his B.S. in nuclear engineering from the University of Missouri. Below he comments on the current popularity of the theory of “Peak Oil” from a socionomic perspective.

I would like to comment on socionomics and ‘Peak Oil.’ At first glance, the Peak Oil Hypothesis – basically that the earth contains a finite amount of oil as opposed to the Abiotic Hypothesis, which states oil is constantly created by geologic processes – would seem to be the Mother of All Fundamentals. As usual, socionomics gives us a unique lens with which to view this currently hot topic in the energy sector.

Peak Oil and depletion arguments in general became popular during the last major bull run in energy prices, which topped out in 1980. When oil was hitting new highs the logic of resource depletion seemed unassailable. In 1959 Dr. M. King Hubbert, a prominent researcher with Shell Oil, had predicted the U.S. would max out conventional oil production in the early 1970s. The U.S. produced around 9.6 millions barrels per day (bpd) in 1970 and has never produced as much in one year since then (2004 production was 5.4 million bpd). As oil prices began to rise, and when production at Prudhoe Bay couldn’t

bring annual output back up to the 1970 level, Peak Oil became a major rationalization for the price leaps that took oil to nearly \$90 per barrel in 2005 dollars. President Carter even issued the 'Carter Doctrine,' stating that the U.S. would intervene militarily in the Middle East to protect vital U.S. interests – oil.

So, with an obvious example of Peak Oil in hand and with no new major oil provinces being opened up after the North Sea and Prudhoe Bay, what happened next? Oil prices began to fall, collapsing to below \$15 dollars per barrel by 1986. Peak Oil and scarcity arguments disappeared. From the point of view of fundamentals, this is inexplicable. But socionomics tells us that mood makes markets; with that insight, the result *is* explicable.

Two decades later, crude oil prices began making another bull run. Peak Oil is suddenly a hot topic again. It is again one of the 'fundamentals' that some analysts use to 'explain' the steep rise in crude oil prices over the last few years. This time, goes the story, it is Middle East production that is about to peak out.

Whether Peak Oil as a geologic phenomenon has already hit or will hit in the next few years or never remains to be seen. But Peak Oil as a popular topic is a socionomic phenomenon. We had two decades of 'fundamentals' in the form of conventional oil depletion in the U.S. The mood dictated that it would be interpreted indifferently, and prices fell. Prices are on the rise again, so Peak Oil is marching right in lockstep as a hot argument to rationalize it. Peak Oil could be strong rationalization for many radical actions that could occur were the general social mood to turn sharply negative.

How society deals with Peak Oil is also a socionomic issue. All the abiotic oil in the world won't change that. Social mood will govern how resources are deployed and what theories will drive that deployment. Socionomics lets us evaluate the claims for Peak Oil in a completely different light. Use that light to your advantage.

## **CITATIONS**

**Tom Slator**, a chartered accountant and licensed insolvency practitioner in Great Britain who holds a degree in engineering and economics from Cambridge University, published Britain's Debt Crisis – A Practical Guide to the New Bankruptcy Laws in 2005. After describing a possible resolution to the debt crisis in Britain according to Austrian economic theory, Slator offers a socionomic perspective:

“A somewhat different perspective is provided by socionomics. Socionomics, the science of history and social prediction, is the brainchild of the U.S. analyst Robert Prechter. It seeks to combine the disciplines of economics and sociology and to answer the question, ‘Why do trends in society often change so rapidly and dramatically?’

“In 1999, for example, the UK and USA stock markets reached unprecedented heights. In the USA, the Dow Jones index was at 11,000 and there were predictions that it would, in a few years' time, reach 40,000 because of the internet and other new technology. Many people believed that peace in the Middle East was at hand and that European Union was a forgone conclusion.

“The reason, according to socionomics, is that there has been a change in social mood. Mood impels action. An increasingly positive social mood causes people to buy shares and buy businesses while an increasingly negative social mood causes people to sell shares. Social mood in turn is determined by the behavior of the crowd as illustrated in the classic book by Charles Mackay, *Extraordinary Popular Delusions and the Madness of Crowds*.

“In crowds, individuals stop thinking for themselves and are caught up in the emotional euphoria of what the crowd are doing. This leads to a boom and bust cycle such as the Dutch tulip mania and the South Sea bubble.

“What can socionomics say about bankruptcy in the UK? Looking firstly at social attitudes toward bankruptcy, we see that, in the relatively short time of 100 years, it has changed from regarding bankrupts as social pariahs for whom life imprisonment was a suitable punishment, through non-imprisonment and successively shorter duration of bankruptcy before discharge, to the present position where bankrupts are regarded as almost heroes of the economy, and even celebrities, and

the duration of bankruptcy is one year or less. As the duration can hardly get any shorter we may speculate that the present position represents a terminal juncture in terms of duration.

“The first sign of a swing of the pendulum in the opposite direction might well be an instigation of bankruptcy restriction orders (BROs) against people who have recklessly incurred debt, this being technically one of the BRO criteria. This would be accompanied by a change in social mood to one more of revulsion against debt rather than the present one, accepted by lenders and borrowers alike, that consumption is good and debt is good.

“Looking secondly at personal insolvency numbers, these have been growing at about 30% per annum compound since 2000, which coincidentally was the terminal juncture in the stock markets. This very high exponential rate of growth is clearly unsustainable in the long term, but given the large numbers relating to consumer debt, both in monetary amounts and numbers of people, there is no reason why it could not continue for another few years.

“We may speculate that the future graph of personal insolvency numbers against time may well show a South Sea bubble type of boom/bust, but it would be a brave person who would try to predict the terminal juncture in time or numbers.”

**Alexander Hamilton** of the U.K. wrote in the Acknowledgements section of his 2005 dissertation, “Asset Price Bubbles and Manias: How Much was the Property Boom Driven by Collective Psychology and Herding Behavior?” submitted as part of the requirements for his M.A. in Property Valuation and Law:

“I would like to thank...Robert Prechter, economist and founder of [elliottwave.com](http://elliottwave.com) who coined the term **socionomics**. His contrarian strategies predicted the boom and bust of the dotcom era, and he predicts a bust for property. His books and articles offer an insight into markets much deeper than most research.”

**The Socionomics Institute**

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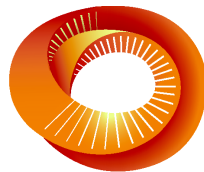
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