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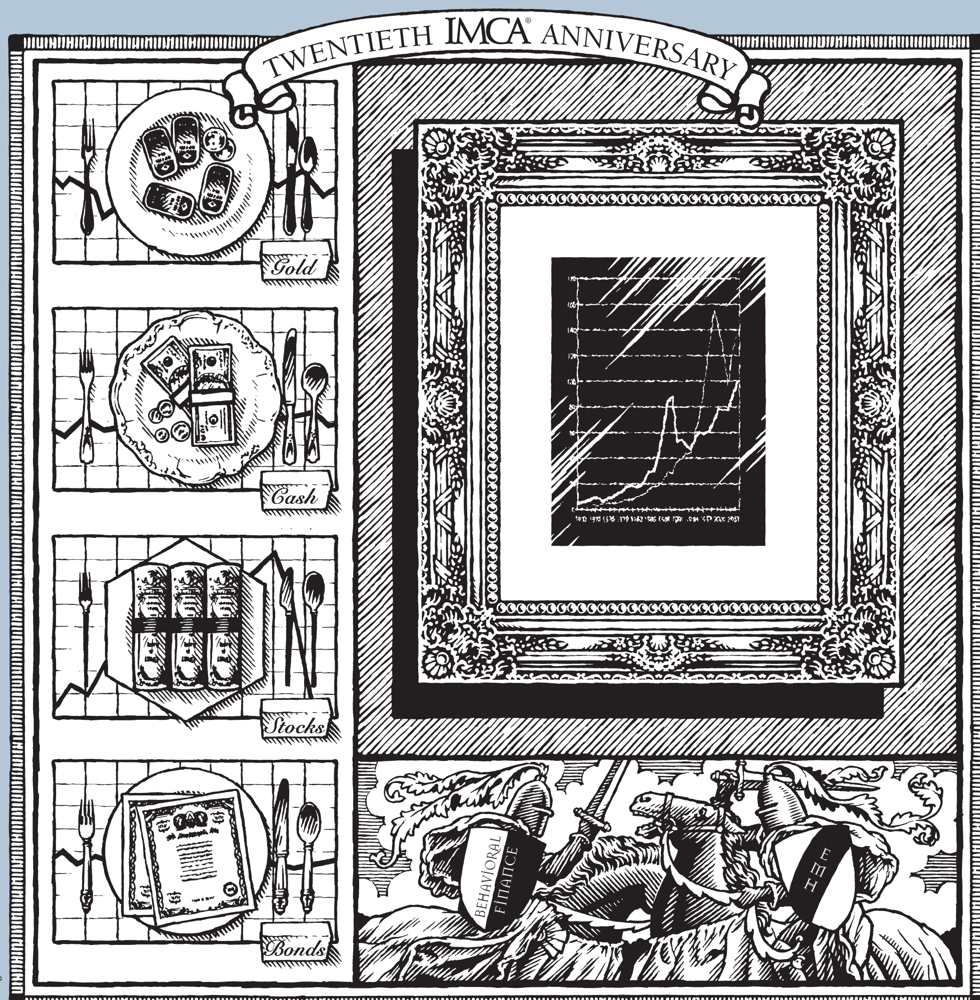

Ken Jacobsen illustration

Martha Stewart's Lessons in Behavioral Finance

By Meir Statman, Ph.D.

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MARTHA STEWART'S LESSONS IN BEHAVIORAL FINANCE

By Meir Statman, Ph.D.

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.

Martha Stewart's Investment Lessons

We listen to investors brag about their winning stocks and want to ask, "May I have a list of all the stocks in your portfolio?" Polite people resist the urge, but prosecutors need not be polite. 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. For example, the cognitive bias of hindsight misled investors into thinking that they knew all along that the level of the NASDAQ would plunge from more than 5,000 in early 2000 to barely more than 1,000 in late 2002, and the emotion of regret misled them into kicking themselves for not selling at 5,000. Martha Stewart's portfolio and her investment behavior offer lessons that financial advisers can use to guide their investors to better portfolios and better behavior.

Miller and Modigliani described rational investors as investors who "always prefer more wealth to less

TABLE 1

Martha Stewart's Portfolio on December 20, 2001.

SECURITY	NUMBER OF SHARES	COST PER SHARE	TOTAL COST	PRICE PER SHARE ON 12/20/01	TOTAL MARKET VALUE ON 12/20/01	UNREALIZED GAIN OR LOSS ON 12/20/01
AGILENT TECHNOLOGIES INC	5,000	30.00	150,000	27.70	138,500	(11,500)
AMAZON COM INC COM	4,000	77.34	309,371	10.15	40,600	(268,771)
AOL TIME WARNER INC	1,600	42.03	67,250	32.78	52,448	(14,802)
APPLE COMPUTER INC	3,200	24.80	79,347	20.67	66,144	(13,203)
AT AND T WIRELESS SVCS	1,500	29.50	44,250	12.77	19,155	(25,095)
AVENUE A INC COM	800	24.00	19,200	1.42	1,136	(18,064)
BANK OF NY CO INC	4,000	24.38	97,531	40.73	162,920	65,389
CHARTER COMMNCATNS INC A	2,000	19.00	38,000	14.82	29,640	(8,360)
CHIRON CORP DEL	1,500	45.05	67,571	45.32	67,980	409
CISCO SYS INC COM	2,000	27.43	54,853	18.29	36,580	(18,273)
CMA CT MUNICIPAL MONEY	125,504	1.00	125,504	1.00	125,504	
DELL COMPUTER CORP	8,000	17.09	136,680	27.58	220,640	83,960
DIGEX INC CL A	5,000	17.00	85,000	2.20	11,000	(74,000)
DOUBLECLICK INC DEL COM	900	73.89	66,501	10.93	9,864	(56,637)
EMC CORPORATION MASS	2,800	29.11	81,507	13.76	38,528	(42,979)
GLOBALSTAR TELECOMM	2,000	35.00	70,000	0.14	280	(69,720)
I-CABLE COMMNCATNS SPADR	1,200	27.00	32,400	13.00	15,476	(16,924)
IMCLONE SYSTEMS INC COM	3,926	16.00	62,848	63.47	249,310	186,462
JDS UNIPHASE CORP	1,000	81.45	81,448	8.20	8,200	(73,248)
KMART CORP	40,000	7.69	307,410	5.20	208,000	(99,410)
LILLY ELI CO	800	65.87	52,696	80.03	64,024	11,328
LUCENT TECHNOLOGIES INC	3,000	42.04	126,123	6.04	18,120	(108,003)
MARTH STWRT L OMNIMED A	5,100	25.51	130,123	16.38	83,538	(46,585)
MCAFEE.COM	500	12.00	6,000	36.55	18,275	12,275
MORGAN ST DEAN WTTR DISC	1,500	43.76	65,646	56.02	84,030	18,384
NDS GROUP PLC SPNSRD ADR	2,150	20.00	43,000	20.25	43,538	538
NOKIA CORP ADR	800	31.18	24,945	23.44	18,752	(6,193)
PALM INC COM	350	38.00	13,300	3.46	1,211	(12,089)
PFIZER INC DEL	1,800	29.84	53,717	41.40	74,520	20,803
REVLON INC CL A	500	19.60	9,800	6.27	3,135	(6,665)
SCHWAB CHARLES CORP NEW	1,650	40.05	66,084	15.30	25,245	(40,839)
SOVEREIGN BANCRP INC COM	5,000	17.58	87,902	11.97	59,850	(28,052)
SYCAMORE NETWORKS INC	3,000	12.67	38,000	4.42	13,260	(24,740)
TELECMUNTN BR SA SPN ADR	500	1.49	743	—	—	Not Calculated
UNITED PARCEL SVC CL B	5,000	50.00	250,000	55.27	276,350	26,350
WAL MART STORES INC	4,000	17.63	70,520	56.26	225,040	154,520
Total					**2,510,793**	**(503,734)**

Source: Government Exhibit 81

and are indifferent as to whether a given increment to their wealth takes the form of cash payments or an increase in the market value of their holdings of shares."[1] Normal investors, like rational ones, prefer more to less, but, unlike rational investors, they are subject to cognitive biases. Normal investors often stumble into choices that offer less because cognitive biases lead them to confuse form with substance. Moreover, emotions often guide normal investors to choices that offer less even in the absence of cognitive biases. Lastly, normal investors often make choices that rational investors reject because they assess what is more and what is less differently than rational investors. Rational investors include in their assessment only utilitarian characteristics that affect wealth, while normal investors also include expressive characteristics that go beyond wealth.

Martha Stewart's Portfolio

Martha Stewart, the former chairman and chief executive officer of Martha Stewart Living Omnimedia, started a catering business out of her home in 1973 and was worth hundreds of millions of dollars when she took her company public in 1999. On December 27, 2001, Ms. Stewart sold shares of ImClone Systems after her Merrill Lynch broker,

TABLE 2

Gains and losses in Martha Stewart's portfolio realized in December 2001.

SYMBOL	NAME	DATE[1] OF REALIZATION	NUMBER OF SHARES	COST PER SHARE	TOTAL COST	GROSS PROCEEDS FROM SALE	SALE PRICE PER SHARE[2]	REALIZED GAIN OR LOSS
A	Agilent Technologies Inc		5,000	$30.00	$150,000	$139,800	$27.96	(10,200.00)
AMZN	Amazon.com Inc		4,000	$77.34	$309,372	$41,360	$10.34	(268,012.00)
AOL	AOL time Warner Inc		1,600	$42.03	$67,250	$51,360	$32.10	(15,889.60)
AAPL	Apple	12/22/01	3,200	$24.80	$79,347	$67,969	$21.24	(11,378.56)
AWE	AT&T Wireless Services Inc		1,500	$29.50	$44,250	$19,635	$13.09	(24,615.00)
AVEA	Avenue A Inc		800	$24.00	$19,200	$1,139	$1.42	(18,061.00)
CHTR	Charter Communication		2,000	$19.00	$38,000	$30,002	$15.00	(7,998.00)
CSCO	Cisco Systems Inc		2,000	$27.43	$54,852	$37,322	$18.66	(17,530.00)
DIGX	Digex Inc		5,000	$17.00	$85,000	$10,485	$2.10	(74,515.00)
DCLK	Doubleclick Inc		900	$73.89	$66,501	$9,991	$11.10	(56,510.10)
EMC	EMC Corp MA		2,800	$29.11	$81,508	$39,032	$13.94	(42,476.00)
GSTRF	Globalstar Telecommunications		2,000	$35.00	$70,000	$290	$0.15	(69,710.00)
ICAB	I Cable Communications		1,200	$27.00	$32,400	$15,121	$12.60	(17,279.00)
IMCL	Imclone	12/27/01	3,928	$16.00	$62,848	$229,523	$58.43	166,674.86
JDSU	JDS Uniphase Corp		1,000	$81.45	$81,448	$8,501	$8.50	(72,947.00)
KM	Kmart Corp		40,000	$7.69	$307,400	$202,000	$5.05	(105,400.00)
LU	Lucent Technologies Inc		3,000	$42.04	$126,123	$18,540	$6.18	(107,583.00)
NOK	Nokia	12/22/01	800	$31.18	$24,946	$19,040	$23.80	(5,905.60)
PALM	Palm Inc		350	$38.00	$13,300	$1,215	$3.47	(12,085.15)
REV	Revlon Inc		500	$19.60	$9,801	$3,180	$6.36	(6,620.50)
SCH	Schwab Charles Corp New		1,650	$40.05	$66,083	$25,575	$15.50	(40,507.50)
SOV	Sovereign Bancorp Inc		5,000	$17.58	$87,900	$59,900	$11.98	(28,000.00)
SCMR	Sycamore Networks Inc		3,000	$12.67	$38,001	$13,350	$4.45	(24,651.00)
						$1,044,329		**(871,199.15)**

1. All losses were realized on December 21, 2001, unless another date is noted.
2. Calculated by dividing gross proceeds by the number of shares.

Source: Government Exhibits 55, 302 and 303.

Peter Bacanovic, tipped her off, through his assistant that Samuel Waksal, ImClone's chief executive officer, and members of his family were dumping shares. On March 5, 2004, Ms. Stewart and Mr. Bacanovic were convicted of obstructing justice and lying to the government about Ms. Stewart's sale of ImClone stock. On October 8, 2004, Ms. Stewart entered the Alderson Federal Prison Camp to serve a five-month sentence.

The documents entered into evidence at trial include an account statement showing the holdings in Ms. Stewart's personal brokerage account at Merrill Lynch as of December 20, 2001. This is the document with the infamous handwritten entry, "@60," reportedly reflecting a stop-loss order from Ms. Stewart to Mr. Bacanovic to sell ImClone shares if and when they dropped below $60 per share. (See table 1.)

According to the account statement, Ms. Stewart's personal account consisted of thirty-six stocks valued at $2,385,289, plus a money-market balance of $125,504, for a total of $2,510,793. Among the thirty-six stocks were twenty-three with unrealized losses, including Amazon, Doubleclick, Palm, Kmart, and Martha Stewart Omnimedia. ImClone was among the stocks with unrealized gains.

Other documents in evidence indicate that in the week after the Merrill account statement was issued, Ms. Stewart sold all the stocks with unrealized losses, except those of Martha Stewart Omnimedia. She sold twenty stocks on December 21 and two stocks (Apple and Nokia) on December 24. She sold her shares of ImClone Systems on December 27.

From these documents, it is possible to determine the price realized and the quantity sold of each stock. ImClone was sold for a gain of $166,675, while the other twenty-two stocks were sold for a total loss of $1,037,874. (See table 2.)

We traced back Ms. Stewart's stock portfolio to the end of June 2000 and calculated its value at \$4,530,730.[2] Ms. Stewart's portfolio lost 47.35 percent of its value between June 30, 2000, and December 20, 2001. The loss is similar to the 51.89-percent loss in the NASDAQ index, which is not surprising given the strong NASDAQ tilt in Ms. Stewart's portfolio. In contrast, the S&P 500 index lost only 21.26 percent. (See figure 1.)

Realizing Losses

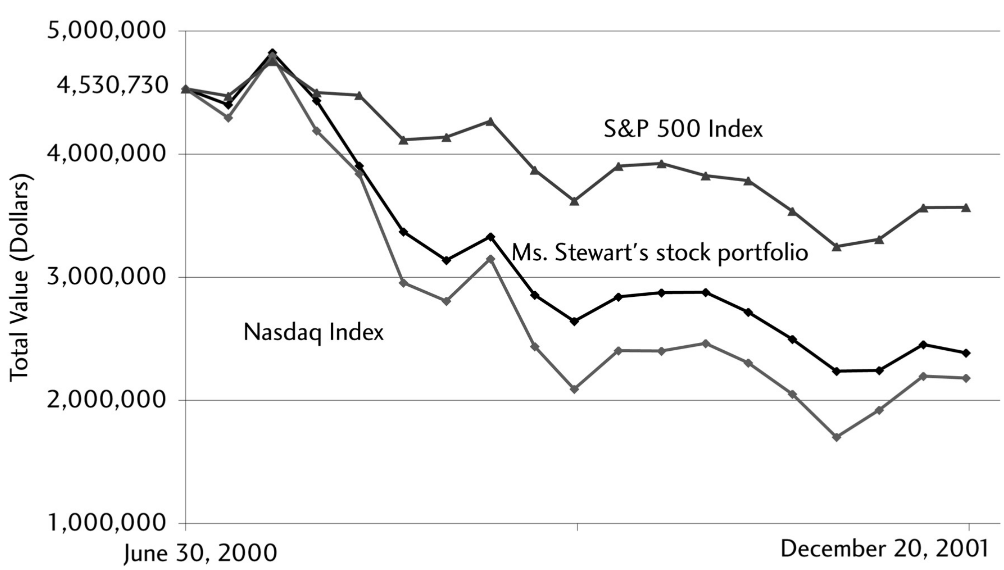
Normal investors are reluctant to realize losses. "Just took lots of huge losses to offset some gains," Ms. Stewart wrote in an E-mail to Mark Goldstein, a friend, on December 22, 2001, "made my stomach turn."[3]

The reluctance to realize losses is puzzling to rational investors because, as Miller and Modigliani wrote, rational investors care only about the substance of their wealth, not its form. In the absence of transaction costs and taxes, paper losses are different from realized losses only in form, not in substance. Moreover, tax considerations give realized losses an edge over paper losses because realized losses reduce taxes while paper losses do not. If Ms. Stewart were rational, she would not have felt her stomach turn when she realized her losses because transaction costs associated with the realization of losses were likely small relative to their tax benefits.

Shefrin and Statman presented the reluctance to realize losses in a behavioral framework.[4] They argued that the reluctance to realize losses stems from a combination of two cognitive biases and an emotion. The first cognitive bias is faulty framing, in which normal investors fail to mark their stocks to market prices. Investors open mental accounts when they buy stocks and continue to mark their value to purchase prices even after market prices have changed. They mark stocks to market only when they sell their stocks and close their mental accounts. Investors need not acknowledge paper losses because open accounts keep alive the hope that stock prices would rise and losses would turn into gains. But hope dies when stocks are sold and losses are realized.

FIGURE 1

THE VALUE OF MARTHA STEWART'S STOCK PORTFOLIO FROM THE END OF JUNE 2000 THROUGH DECEMBER 20TH, 2001, AND THE CORRESPONDING VALUES OF THE PORTFOLIO HAD IT BEEN INVESTED IN THE NASDAQ INDEX OR THE S&P 500 INDEX.



The second cognitive bias that plays a role in the reluctance to realize losses is hindsight bias, which misleads investors into thinking that what is clear in hindsight was equally clear in foresight. Hindsight bias misleads investors into thinking that they could have seen losing stocks in foresight, not only in hindsight, and avoided them. The cognitive bias of hindsight is linked to the emotion of regret. Realization of losses brings the pain of regret when investors find, in hindsight, that they would have had happier outcomes if only they avoided the losing stocks.

Postponing the realization of losses until December is one defense against regret. Normal investors tend to realize losses in December, and Ms. Stewart followed that practice when she realized her losses in December 2001. There is nothing rational in the role that December plays in the realization of losses. Investors get no more tax benefits from the realization of losses in December than in November or any other month. Indeed, Shefrin and Statman showed that it makes rational sense to realize losses when they occur rather than wait until December. The real advantage of December is the behavioral framing advantage. What is framed as an investment loss in November is framed as a tax deduction in December.

While realizing gains brings the joy of pride rather than the pain of regret, realizing gains involves a choice, and choice sets up investors for regret.

Ms. Stewart realized her losses in December at the advice of Peter Bacanovic, her broker. Brokers and financial advisers have always been aware of the reluctance of investors to realize losses, and they have developed methods to overcome that reluctance. Postponing the realization of losses to December is one such method, and a "swap" is another. A swap involves the realization of a loss in one asset—a stock, a bond, or a mutual fund—and the use of the proceeds to buy another asset.

Normal investors like swaps because swaps blur mental accounts and distract their attention from the fact that they are realizing losses. Consider the mental accounting benefits of swaps recommended by Gross in his manual for brokers: "The two separate transactions (moving out of the loss and moving into a new position) are made to flow together by the magic words 'transfer your assets.' The prospect thought he was making a single decision, switching one investment into another. He was not being asked to think in terms of selling XYZ..."[5]

Financial Advisers as Scapegoats

Realizing losses turns a stomach, but normal investors are often reluctant to realize gains as well. While realizing gains brings the joy of pride rather than the pain of regret, realizing gains involves a choice, and choice sets up investors for regret. How would you feel if you chose to sell a stock only to watch it soar on the following day? Martha Stewart was reluctant to realize gains. Peter Bacanovic said in his interview with SEC investigators: "I have often recommended that she sell stocks at high prices to lock in gains. And she's very loath to sell stock, ever, and has often watched good gains evaporate. The perfect example would be Kmart... 'Please, let's sell the stock at $8. You have so many shares, your basis is 7.40, you're getting really close here.' You wound up selling the stock at 5. But I think, even that, in hindsight, looks lovely."[6]

Realizing gains as well as realizing losses is easier for investors who are able to turn financial advisers into regret-bearing scapegoats. Such investors take credit for choices that turn out well while shifting blame for choices that turn out poorly. They are depicted in a common broker lament: When the stock goes up the customer says, "I bought the stock," and when the stock goes down the customer says, "My broker sold me the stock." But some investors are, by nature, unable to shift blame. Juror No. 6 at Martha Stewart's trial is one such investor. "She doesn't blame her broker when an investment goes bad," a reporter wrote of Juror No. 6, based on her answer to a question posed during the jury selection process. "Those are our gains and our mistakes," Juror No. 6 said.[7]

Ms. Stewart has some of Juror No. 6's fortitude, but not much. Ms. Stewart acknowledged her choices and assumed blame for them in one sentence of a November 11, 2000, E-mail to Mr. Bacanovic: "I've made two or three horrendous mistakes and not sold when I was still far ahead." But her sentence before that used "we" rather than "I": "We have just watched the slide and have done nothing, and I'm none too happy."[8]

Investors are often unkind even when they do not turn financial advisers into regret-bearing scapegoats. Martha Stewart was not kind to Peter Bacanovic, and she was even less kind to Douglas Faneuil, Mr. Bacanovic's assistant. Mr. Faneuil wrote in an E-mail to a friend that "Martha yelled at me again today..." In another E-mail, Mr. Faneuil complained that Ms. Stewart had hung up on him, adding that at one point Ms. Stewart made the "most ridiculous sound I've heard coming from an adult in quite some time, kind of like a lion roaring underwater."[9] Mr. Faneuil testified that Mr. Bacanovic remarked, "See what I have to deal with?" when Mr. Faneuil told him about Ms. Stewart's telephone call.[10]

Samuel Waksal, another of Mr. Bacanovic's clients, added to Mr. Bacanovic's life even more stress and grief than Ms. Stewart. Mr. Bacanovic answered questions posed by the SEC investigators:

Q: Do you like Sam Waksal?
A: I don't mind him. I mean, I don't mind him.

Q: Is there anything you don't like about him?
A: Yes. The stress and grief that he has caused my office in the course of our business dealings, that have taken away from the time for much more productive relationships and deserving clients.[11]

Mr. Faneuil added some details. He "fielded several calls from Samuel Waksal's accountant, Alan Goldberg, who brusquely told him it was going to be a busy day and he should treat the Waksals like his "No. 1 client" and "ignore all other business that day."[12]

Overcoming Cognitive Biases

Optical illusions are cognitive biases, and we are all subject to them. Even though almost all people today accept the scientific conclusion that the earth revolves around the sun, we continue to be subject to that optical illusion of seeing the sun revolve around the earth. The sun-and-earth example shows that people can learn and overcome cognitive biases. After all, almost all people once believed that the sun revolves around the earth, and those who argued otherwise risked life imprisonment or other serious punishment. But overcoming cognitive biases is not easy. Consider the overconfidence of normal investors in their ability to pick winning stocks as long as they have the time to track them. Peter Bacanovic answered the following questions about Ms. Stewart, posed by SEC investigators:

Q: And why does she not like to own a lot of stocks?
A: Because, in her busy life, it was hard for her to keep track of a great number of stocks.

Q: Does she make attempts to keep track of—
A: Yes, she does.[13]

Losses shake the confidence of investors in their stock-picking abilities, and they shook Ms. Stewart's confidence enough to consider placing her money with a professional money manager. She wrote in her November 11, 2000, E-mail to Mr. Bacanovic: "The account is a mess ... I think it's time for me to give my money to a professional money manager who will take a bit more care about overall market conditions and political and economic problems."[14]

Utilitarian and Expressive

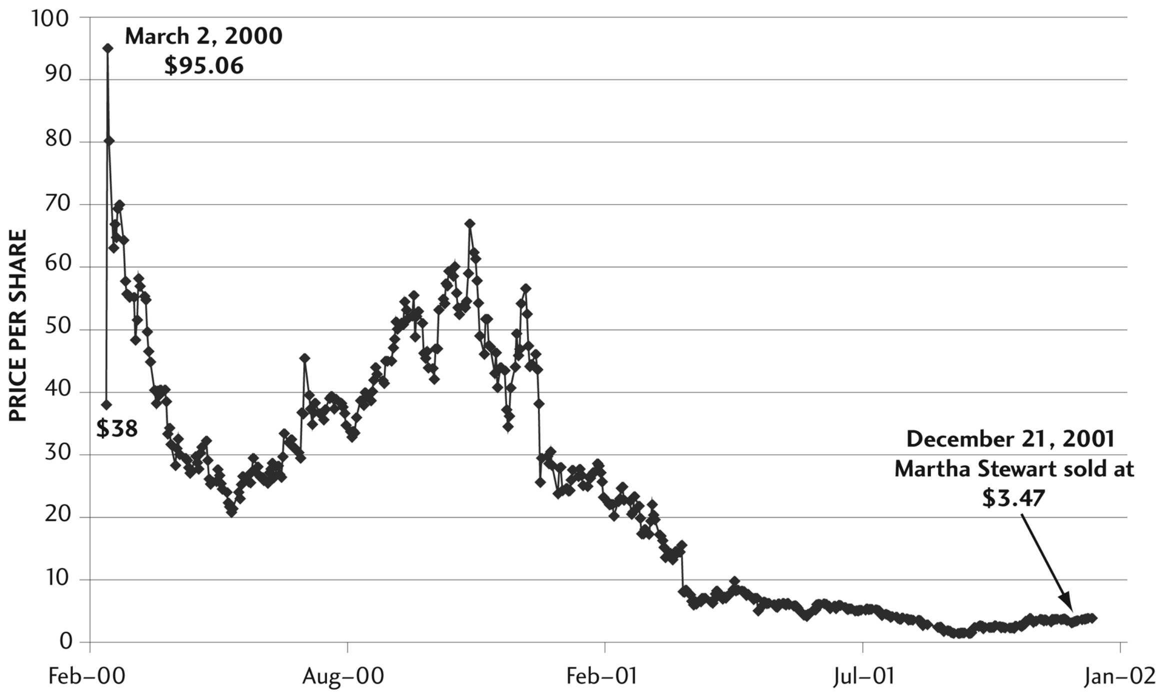
Here is a ditty written by a rational investor:

A cow for her milk,
A hen for her eggs,
And a stock, by heck
For her dividends.[15]

Rational investors feel no affection for stocks of companies that make sweets and no revulsion against stocks of companies that make cigarettes. Rational investors buy stocks for their utilitarian characteristics, namely cash flows such as dividends. But normal investors feel affection for some stocks and revulsion against others. Normal investors consider expressive characteristics of stocks, such as loyalty or social responsibility, along with utilitarian ones. Perry

FIGURE 2

CLOSING PRICES OF SHARES OF PALM, INC.



described an investor who was loyal to drug company stocks she inherited from her father: "Dad said never sell a drug company stock."[16]

Similarly, Martha Stewart clung to Kmart's stock despite the advice of her broker, perhaps because she felt loyalty to the company that sells her merchandise.

Rich and Poor

Martha Stewart is a normal investor, but she is a rich one. Ms. Stewart lost money on Amazon, Doubleclick, Lucent, and twenty more stocks, as did other investors who concentrated their portfolios in dot-coms, but her portfolio was still worth more than $2.5 million in December 2001. Riches bring advantages. A reporter noted that, "unlike others involved in the tech stock boom, Stewart wasn't chasing dot-coms with the milk money. Her 60-percent stake in her own company, Martha Stewart Living Omnimedia Inc., was worth more than $500 million."[17]

Riches also placed Ms. Stewart on the privileged list of investors who were allocated hot IPO shares at their offering prices. The stocks that Ms. Stewart bought at their IPOs include Charter Communication, Digex, Agilent, Palm, and several more. Ms. Stewart would have been ahead if she had flipped her shares on their first trading day or even months afterward. But Ms. Stewart waited and watched her gains turn into losses. For example, Ms. Stewart bought 350 shares of Palm, Inc., at the $38 offering price and watched the price zoom to $95.06 at the end of the first trading day. Palm shares never have reached that price again. But figure 2 shows that Ms. Stewart could have sold the shares even many months later for much more than the $3.47 per share she received when she finally sold them on December 21, 2001.

Riches bring advantages, even if some are squandered. But riches also bring disadvantages. For example, Statman found that survey respondents are likely to judge people who trade on inside information more harshly when they are described as well-off executives than when they are described as summer interns.[18] Ms. Stewart learned the disadvantages of riches when her verdict was announced. The verdict "is a victory for the little guys," said Chappell Hartridge, one of the jurors. He added that the jury was turned off by the celebrities who showed up to support Ms. Stewart, including Bill Cosby and Rosie O'Donnell. Jurors saw their presence as "a little bit of an insult," Hartridge said. "Was that supposed to sway our decision?"[19]

Financial advisers encounter many rich investors who have accumulated more than they can possibly spend in many lifetimes. Yet most want to accumulate even more. The desire for more often places investors close to legal lines, whether the insider-trading line, the truth-telling line, or the tax-evasion line.

Consider cardiologist John McCartney, one of many investors described as the "angry affluent." "I hate the IRS," Dr. McCartney said. He set up a $10-million tax shelter in the form of a charitable split-insurance policy. "I don't want to give them another penny of my money, and this plan helps it go to my kids and grandkids, and to the causes I feel are important."[20] Unfortunately, those close to the legal line often cross it. That is true for Martha Stewart, who crossed the truth-telling line, and for John McCartney, who crossed the tax-evasion line. The IRS invalidated Mr. McCartney's tax shelter and left him with less rather than with more.

Conclusion

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 normal investors, 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, and they can use the story to make clients aware of their own cognitive biases and emotions. For example, financial advisers can share with clients examples and descriptions of cognitive biases and emotions.[21] Awareness is a step in the right direction, but it is rarely sufficient. Financial advisers can follow 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 it easier to realize losses because it makes loss realization automatic. (Note also how the term "harvesting" creates a positive frame. Harvesting connotes sweet fruit, not bitter losses.)

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.

ENDNOTES

1. Merton Miller and Franco Modigliani, "Dividend Policy, Growth, and the Valuation of Shares," *Journal of Business*, 34, no. 4 (1961): 411–433, 412.

2. Documents introduced at trial include account statements that show the holdings of Ms. Stewart's personal brokerage account at Merrill Lynch, including the quantity owned of each stock, the cost basis per share, and the total cost basis. We calculated the market value of the same portfolio of stocks on a monthly basis from June 30, 2000, to December 20, 2001. It was impossible to track the portfolio any earlier than June 2000 because several of Ms. Stewart's holdings did not trade publicly before that date. For example, Ms. Stewart held stock in AT&T Wireless, which was issued in an IPO in June 2000.

3. Quoted from government exhibit 297 in *United States* v. *Martha Stewart and Peter Bacanovic.*

4. Hersh Shefrin and Meir Statman, "The Disposition to Sell Winners Too Early and Ride Losers Too Long: Theory and Evidence," *Journal of Finance* 40, no. 3 (1985): 777–790.

5. LeRoy Gross, *The Art of Selling Intangibles: How to Make Your Millions by Investing Other People's Money* (New York: New York Institute of Finance, 1982): 152.

6. Securities and Exchange Commission, "In the Matter of Trading in the Securities of ImClone Systems, Inc.," (February 13, 2002): 83–84.

7. Thomas S. Mulligan, "Diverse Group of Jurors Deciding Stewart's Fate," *Los Angeles Times* (March 4, 2004): C1.

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