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Dead Cat Bounce - Demand Reversal Following the Bursting of a Bubble

39 Pages

Posted: 4 May 2017

Kolja Johannsen (https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=2347299)

University of Warwick, Warwick Business School

Date Written: May 27, 2016

Abstract

This is the first paper to theoretically analyze the temporary reversal of the downward trend in financial assets, also known as dead cat bounce or bear market rally. We show that preferences according to cumulative prospect theory lead an investor to take excessive risk and unprofitable positions in order to recover an initial loss in a declining market. The loss driven behavior results in premature re-entering into the market. We show that heterogeneous investors enter at the same time despite differences in the reference point, wealth and initial loss. The resulting shift in aggregate demand can explain the sudden but temporary reversal common in declining financial markets.

Keywords: Asset pricing, bubbles, cumulative prospect theory, behavioral finance**JEL Classification:** D03, D53, G01, G02[Suggested Citation](#) >[Show Contact Information](#) >[Download This Paper \(Delivery.cfm/SSRN_ID2961304_code2347299.pdf?abstractid=2961304&mirid=1\)](https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID2961304_code2347299.pdf?abstractid=2961304&mirid=1)[Open PDF in Browser \(Delivery.cfm/SSRN_ID2961304_code2347299.pdf?abstractid=2961304&mirid=1&type=2\)](https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID2961304_code2347299.pdf?abstractid=2961304&mirid=1&type=2)

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