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Chapter 20 Human behavior and the efficiency of the financial system

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Abstract

Recent literature in empirical finance is surveyed in its relation to underlying behavioral principles, principles which come primarily from psychology, sociology, and anthropology. The behavioral principles discussed are: prospect theory, regret and cognitive dissonance, anchoring, mental compartments, overconfidence, over- and under-reaction, representativeness heuristic, the disjunction effect, gambling behavior and speculation, perceived irrelevance of history, magical thinking, quasi-magical thinking, attention anomalies, the availability heuristic, culture and social contagion, and global culture.

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Keywords

efficient markets; random walk; excess volatility; anomalies in finance; stock market; prospect theory; regret and cognitive dissonance; anchoring; mental compartments; overconfidence; overreaction; underreaction; representativeness heuristic; the disjunction effect; gambling behavior and speculation; irrelevance of history; magical thinking; quasi-magical thinking; attention anomalies; the availability heuristic; culture and social contagion; global culture

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