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Detecting Anchoring in Financial Markets

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Abstract

Anchoring is a term used in psychology to describe the common human tendency to rely too heavily (anchor) on one piece of information when making decisions. Here a trading algorithm inspired by biological motors, introduced by L. Gil [2007], is suggested as a testing ground for anchoring in financial markets. An exact solution of the algorithm is presented for arbitrary price distributions. Furthermore the algorithm is extended to cover the case of a market neutral portfolio, revealing additional evidence that anchoring is involved in the decision making of market participants. The exposure of arbitrage possibilities created by anchoring gives yet another illustration on the difficulty proving market efficiency by only considering lower order correlations in past price time series.

Keywords:

Anchoring | Behavioral finance | Biological motors | Trading algorithm | Brownian motion

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