Journal of Behavioral Finance ›

Volume 11, 2010 - Issue 2

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Detecting Anchoring in Financial Markets

Jørgen Vitting Andersen

Pages 129-133 | Published online: 02 Jun 2010

Cite this article https://doi.org/10.1080/15427560.2010.483186

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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

ACKNOWLEDGMENTS

The author is grateful to L. Gil for valuable discussions. The author would like to thank Julie Boudreau for help in editing of the manuscript and would like to thank the Collège Interdisciplinaire de la Finance for financial support.

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