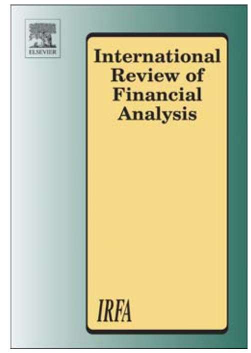

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Neoclassical Finance, Behavioural Finance and Noise Traders: A Review and Assessment of the Literature

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Abstract

While mainstream neoclassical finance ignores the role played by noise traders, a significant amount of empirical evidence is available to show that noise traders are active market participants and that their participation gives rise to market anomalies. Unlike neoclassical finance, behavioural finance allows for market inefficiency on the grounds that market participants are subject to common human errors that arise from heuristics and biases. In this paper we review the literature on the behaviour of noise traders and analyse the consequences of their presence in the market, starting with a distinction between neoclassical finance and behavioural finance. We identify the market anomalies that provide evidence for the tendency of markets to trade at irrational levels, demonstrate how noise trading is related to some market fundamentals, and describe the models used to quantify noise trader risk.

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