



Full length article

Society for Experimental Finance Presidential Address 2015



Charles N. Noussair

Department of Economics, Eller College of Management, The University of Arizona, Tucson, AZ 85721, United States

ARTICLE INFO

Article history:

Received 18 January 2016

Received in revised form 23 January 2016

Accepted 22 February 2016

Available online 27 February 2016

Keywords:

Society for Experimental Finance

Presidential Address

2015

ABSTRACT

It has been a privilege to be the President of the Society of Experimental Finance for 2014–2015, during a period of considerable progress in the establishment of the field. Below, I describe what I view as the most important recent development in experimental finance, the institutionalization of the field. I also give a very brief overview of the most active and productive research streams in the area and offer a few thoughts about possible productive avenues of future research in experimental finance.

© 2016 Published by Elsevier B.V.

1. Developments in experimental finance

In my view, the most prominent development in experimental finance over the last few years has been its institutionalization. This institutionalization consists of three main pillars. The first is the establishment of the *Society for Experimental Finance*, with a distinct, albeit still evolving, governance structure and bylaws, and a mission to organize and to promote the field of experimental finance. The second is the holding of annual meetings, called the *Experimental Finance* meetings, which have been expanding in attendance and the number of presentations over the last few years. The third is the founding of this journal, the *Journal of Behavioral and Experimental Finance*, which has as one of its prime missions to provide an outlet for the dissemination of experimental research.

The meetings and the journal also help define what falls under the domain of experimental finance. The scope of experimental finance, like perhaps that of any field of science, is in part defined by the solidifying of a consensus among its practitioners, in addition to objective criteria. By submitting to the journal, presenting work at the conference, and joining the society, researchers associate themselves with the new field. However, the tie that seems to bind

the self-identified practitioners of experimental finance together is their use of a common methodology, and their adherence to a specific set of norms and conventions governing the collection and analysis of data. The methodology is the use of controlled experiments with human participants, and the norms include the use of an incentivized payment structure and a prohibition on the deception of participants, practices that were imported from experimental economics.

While there is no precise definition of the field of experimental finance, I am partial to one along the following lines. *Experimental finance is the design, implementation, and analysis of synthetic settings, in which human subjects make decisions, for the purpose of answering one or more research questions related to finance.* Experimental finance is thus not a branch of behavioral finance, which employs theoretical, empirical, agent-based, and experimental methodologies, though the field of experimental and behavioral finance obviously intersect. While some elements in behavioral finance draw on experimental findings for their assumptions, they need not do so, and behavioral finance typically also finds inspiration in non-experimental data. Furthermore, some experimental studies do support classical theories assuming a high degree of rationality rather than propositions from behavioral finance. Nonetheless, the fact that behavioral finance has so productively employed behavioral assumptions that originated in experimental work in economics and psychology is clear

E-mail address: cnoussair@email.arizona.edu.

evidence of the potential of experiments to inform theory and empirical work in finance.

2. What topics are being studied?

A glance at the program of the most recent annual conference of the Society for Experimental Finance, held in Nijmegen, The Netherlands, in June 2015, reveals the main themes of current research in experimental finance, and provides a preview of the topics that are likely to appear in the journals in the next few years. A subjective classification of the research areas considered based on the abstracts in the conference program yields the following distribution of topics. Of the papers that were presented at the conference, 46% can be classified as studying asset pricing, 36% as focused on individuals' investment decisions, and 13% considering strategic interaction. In my brief listing of the specific topics being studied below, I will mention the general themes of the work presented at the conference, while avoiding reference to specific studies.

The principal themes of current work on asset pricing include the following. One theme is the relationship between trader characteristics on one hand, and market pricing as well as individual outcomes in asset markets on the other. The relationship between the cognitive ability of traders and market behavior is becoming well-established, and it is clear that greater cognitive ability is closely related to more accurate price discovery, improved market efficiency, and greater earnings at the individual level. Other economic parameters, such as risk aversion, and psychophysiological variables such as stress, cognitive load, self-control, and hormone levels, and their relationship to mispricing and individual behavior are also topics of current interest. A second theme is the effect of market experience on subsequent beliefs, risk aversion levels, and behavior in subsequent tasks. A third area is the impact of institutions and rules, such as make-or-take fees, tournament incentives, disclosure and holding requirements, on asset prices. A fourth line of inquiry has a focus on the particularities of real estate markets, including the existence of simultaneous rental and ownership markets, and the trading frictions characteristic of such markets.

A number of lines of research are prominent in the area of individual investment decisions. One important line of inquiry is the nature of decision making in the presence of ambiguity. The relevance of this to financial markets is clear since investment decisions are frequently undertaken in situations in which probabilities are unknown. A second stream is investigating the incidence and pervasiveness of anomalies of individual choice, such as overconfidence, the hot hand fallacy, the gambler's fallacy, home bias, exponential growth bias, debt aversion, and their impact on investment and portfolio allocation decisions. A third line of research investigates how experience and feedback affect such decisions, and which learning processes accurately describe dynamic investment patterns. A fourth topic is the search correlates of individual investment decisions. Such correlates include risk aversion, cognitive ability, and financial literacy.

The third general topic is the study of strategic interaction in settings relevant to finance. These typically consist of settings in which asymmetric information and moral hazard are present. Two particular contexts seem to be of particular interest. One of these is a lender–borrower interaction, which involves trust on the part of the lender and reciprocity on the part of the borrower. The second is the relationship between an investor and an agent making trading decisions on her behalf, another setting in which the two parties' incentives may be misaligned.

3. Research on asset pricing

As indicated earlier, almost one half of the papers presented at the most recent Experimental Finance meetings concern asset pricing. This is a longstanding focus of experimental work and unlike the two other main areas of active research described above, is more specifically focused on questions within the exclusive purview of finance. Experimental research on asset pricing originates in a collection of papers published in the 1980s (Forsythe et al., 1982; Plott and Sunder, 1982, 1988; Friedman et al., 1984; Smith et al., 1988). These authors adapted earlier methods from experimental economics used to study markets for perishable goods under full information (Smith, 1962, 1982) to markets with either asymmetric information or for multi-period assets, two features characteristic of financial markets. These early studies established a body of initial results that fueled an extensive follow-up literature. The principal results from the initial studies included the following. A market for a multi-period-lived asset exhibits convergence to rational expectations price levels when the life of the asset is short (Forsythe et al., 1982). Futures markets aid in this process of price discovery and also help to reveal privately-held information (Friedman et al., 1984). Price bubbles and crashes tend to form when the asset has a relatively long life (Smith et al., 1988). Insider information is revealed by the market when sufficiently numerous insiders are present (Plott and Sunder, 1982), though aggregation of diverse components of privately-held information is more challenging (Plott and Sunder, 1988).

Several recent surveys of the topic also help give an overview of the state of the field and the work that has been done over the last three decades. Noussair and Tucker (2013) list five of the most prominent themes in research on experimental asset markets that have been pursued in this period, beyond the lines of research extending the initial studies mentioned above. These themes are (1) the impact of market microstructure on pricing and outcomes, (2) the efficiency of parimutuel betting markets, (3) the relationship between market and individual behavior and outcomes on the one hand, and trader characteristics such as traits, emotional states, and the propensity to use different strategies on the other, (4) the impact of the public release of information to market participants, and (5) tests of the predictions of the Capital Asset Pricing Model.

Duxbury (2015a,b) also lists and surveys a number of areas of experimental finance. He covers the following research streams: (i) tests of financial theories of investment decisions and documentation of a number of biases

Download English Version:

<https://daneshyari.com/en/article/931668>

Download Persian Version:

<https://daneshyari.com/article/931668>

[Daneshyari.com](https://daneshyari.com)