

ECONOMICS THESIS PROPOSAL

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General Field: Finance
Proposal Title: A Better Way to Model Financial Markets
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Question

What advantages does the Adaptive Markets Hypothesis have over Efficient Market Hypothesis and what new insights will this approach provide. How well does this theory apply to real financial markets.

Area Efficient Market Hypothesis

Relevance

Despite the popularity of EMH among academic theorists, this view has not been adopted by those actually participating in the financial markets. There must be a reason why so much empirical evidence does not agree with theory.

Theory

In contrast to the Efficient Market Hypothesis, Adaptive Markets Hypothesis takes an evolutionary view on the nature of financial markets. This perspective implies that market behavior is not necessarily intrinsic and exogenous but evolves by natural selection and depends on the particular environment through which selection occurs. A related field is Behavioral Economics, which is primarily concerned with the rationality, or lack thereof, of economic agents.

Methods

I will analyze specific historical prices and note if/when market inefficiency is persistent in order to uncover the extent of evolutionary nature in financial markets.

Issues

This is a relatively new field of economics, and the amount of published research done on the topic is not abundant. I have access to a few case studies of AMH and many resources in the related field of behavioral finance.

References

Grossman, S. and J. Stiglitz, "On the Impossibility of Informationally Efficient Markets." *The American Economic Review* (1980) 393-408.

Lo, A., "Reconciling Efficient Markets with Behavioral Finance: The Adaptive Markets Hypothesis." *Journal of Investment Consulting* 7(2005), 21-44.

Barberis, Nicholas and Thaler, Richard H., "A Survey of Behavioral Finance" (September 2002). Available at SSRN: <http://ssrn.com/abstract=327880> or DOI: 10.2139/ssrn.327880

Faculty Input

Prof. Woglom recommended that I read some essays and books on behavioral finance as well as some responses from the EMH side.