

Traders' Expectations in Asset Markets: Experimental Evidence
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Abstract:

We elicit traders' expectations of future price trajectories in repeated experimental markets for a 15-period-lived asset. The market has a structure that is known to generate price bubbles and crashes. We investigate the evolution of trader expectations as bubbles form and as the markets converge to fundamental pricing. We find that individuals' beliefs about prices are adaptive, and primarily based on past trends in the current and previous markets in which they have participated. Most traders do not anticipate market downturns the first time they participate in a market, and when experienced, they typically overestimate the time remaining before market peaks and downturns occur. Convergence to fundamental pricing appears to occur as a process of iterated use of profitable strategies on the part of individuals given their adaptive expectations. This process eventually leads to fundamental pricing and common expectations that prices will track fundamentals. When prices deviate from fundamental values, belief data is informative to an observer in predicting the direction of future price movements and the timing of market peaks.