Investor Behavior and Economic Cycles: The Impact of Human Biases and Cognitive Limitations on Economic Booms and Busts

Beryl Y. Chang

European School of Economics, Vernon Gerety, VGAdvisors LLC

Abstract

In light of the current great recession, this paper examines whether investor behavior and biases in information processing had contributed to the severity of economic cycles and how these human factors were revealed across time taking into account regulatory, technology, and market changes. We explore the impact of market participants’ behavior on the economic cycles under various market conditions using time series/panel data and investigate (i) whether human behavior exacerbated the baseline dynamics of economic cycles across time (ii) what and how behavioral characteristics contribute to a cycle when market rules and conditions change and (iii) policy implications for sustainable growths in an economy.

Keywords: behavioral finance; behavioral economics; economic cycles; investor behavior; human nature; emotion; cognitive limitation; neuroeconomics; financial crisis; market sentiment

JEL Codes: A3; E3; G3

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