

Chapter 7

Conclusion

Empirical literature suggests that conservatism bias causes only asset price underreaction to new information and representativeness heuristic causes only asset price overreaction to new information. This book formally examines the role of conservatism bias and representativeness heuristic in determining asset price overreaction or underreaction to new information. Specifically, the models in Chaps. 2–5 of this book prove theoretically that either conservatism bias or representativeness heuristic is capable of generating both asset price overreaction and underreaction to new information. These results hold in a competitive securities market with noise traders or a security market with imperfect competition allowing strategic interaction among traders. Although the results in Chaps. 2–5 are purely theoretical, they shed some light on the cause of the asset price overreaction and underreaction to new information. The model in Chap. 6 attempts to build a realistic model to explain the cause of the asset price underreaction or overreaction to new information by using both conservatism bias and representativeness heuristic.

The future research direction in this area is to further explore how conservatism bias and representativeness heuristic can be used to explain the empirical phenomena of asset price overreaction or underreaction to new information.