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ILLUSIONARY FINANCE AND TRADING BEHAVIOR

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Abstract

One important aspect of financial markets is that there might be some traders that intentionally mislead other market participants by creating illusions in order to obtain a profit. We call this new concept illusionary finance. We present an analysis of how illusions can be created and disseminated in financial markets based on certain psychological principles that explain agents' decisions under time pressure and polysemous signals. We develop a simple model that incorporates the illusions in the price formation process. Furthermore, using powerful simulations, we show how illusions can be incorporated, directly or indirectly, in the expected prices of the traders.

Keywords: illusionary finance, behavioral finance, evolutionary finance, neuroeconomics.

JEL Classification: C32, C35, G10.

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