

The Market Impact of Boundedly Rational Traders

Carl Chiarella, Xue-Zhong He and Min Zheng

School of Finance and Economics, University of Technology, Sydney

This paper considers heterogeneity in investors and their aversion to model misspecification. By use of BSDE (backward stochastic differential equation) methods and the consensus investor approach, we show the important role played in the market by heterogeneous beliefs, which can be viewed as the source of large trading volumes. By making a comparison of the consensus investor model and the classical representative agent model, the paper shows the difference between the homogeneous investor market and heterogeneous investor market and through this is able to give an explanation to the riskless rate puzzle.