

Abstract

In many financial agent based models, the concept of adaptive switching behavior is employed as a substitute for the, elegant yet unrealistic, assumption of rational expectations. Studies estimating these models however frequently suggest that agents do not behave adaptively. To better understand the source of this discrepancy, we propose a test for the presence of switching which does not require us to specify beforehand the exact form of the switching mechanism nor the strategies among which agents can choose. We verify the ability of the test to detect switching by Monte Carlo simulations and then apply it to stock prices from the New York Stock Exchange. The null hypothesis of the absence of switching is strongly rejected. Furthermore, we assess robustness of this finding by applying the test individually to various sub-sets of the data-set. The switching is prevalent in all considered sub-periods and in all groups of stocks categorized by traded volume.

JEL Classification G02, G12, G14, D83, D84

Keywords Bounded Rationality, Adaptive Switching, Intensity of Choice, Market Efficiency

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