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Neoclassical and Behavioral Finance: A Synergy of Approaches in Current Debates and in Contemporary Financial Research

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One of the most prominent changes in the development of finance as a scientific discipline at the turn of the 21st century has been a rapidly increasing interest in behavioral finance: the field of study that combines the knowledge of finance with psychology and proposes psychology-based theories to explain various phenomena that occur in the financial environment.

Behavioral finance has grown in importance all over the world, and it became a challenge to the neoclassical theory of finance that had been prevailing so far and which relies mainly on a broad assumption that the decisions made by different groups of agents in financial markets are fully rational. Currently, both those approaches constitute major fields of intensive empirical investigations within the realm of the modern science of finance, although they are sometimes considered as complementary rather than competitive concepts.

Research in finance deals with studying different issues concerning money, including provision of funds, funds allocation, managing and profiling project risk, etc. Both neoclassical and behavioral finance approaches attempt to find the way to explain the decision-making processes regarding these issues; however they use different tools, apply different perspectives, and often reach different conclusions.

The international conference "Neoclassical and Behavioral Finance," organized at the University of Łódźon June 26–27, 2014, was an opportunity to discuss and compare the achievements of both traditional finance and behavioral finance approaches. It was one of the first such forums in Poland where behavioral finance researchers from various scientific centers and the researchers representing the neoclassical approach to finance could present and debate their achievements. The outcomes of discussions at the conference sessions demonstrate that the combination of these two research approaches may become an important method, which can explain many puzzling financial phenomena and, ultimately, lead to a new paradigm in finance.

In this issue of Emerging Markets Finance and Trade, we present the five best articles selected from the "Neoclassical and Behavioral Finance" conference. They deal with various aspects of financial systems, financial markets, and corporate finance analysis, and they present considerations that include both the neoclassical and behavioral perspectives. Gonzalo Camba-Méndez, Konrad Kostrzewa, Anna Marszal, and Dobromił Serwa, in the article "Pricing Sovereign Credit Risk of Poland: Evidence from the CDS Market," analyze the sovereign credit risk of Polish debt during the period of a global financial crisis. They find that the most likely scenario of a sovereign credit event in Poland is associated with temporary liquidity problems rather than a full-blown sovereign default with a major debt restructuring. Their conclusions are important in understanding of the role of the time-varying expected losses in the pricing of sovereign risk.

Wojciech Grabowski and Aleksander Welfe, in the article "An Exchange Rate Model with Market Pressures and a Contagion Effect," propose a model that includes variables which reflect the behavioral aspects of decision-making processes in the currency markets, such as the contagion effect among countries in the same region. Their methodology combines the classical purchasing power parity (PPP) and uncovered interest rate parity (UIP) hypotheses with the effects of risk aversion in financial markets and of currency market pressures. Using the data from Poland, they find that the currency market instabilities arise not only from fundamental factors (such as economic activity or the balance of payments) but also from the contagion effect related to investors' tendency to perceive Poland and its neighbors, the Czech Republic and Hungary, as one homogenous group of countries.

Adam Zaremba and Adam Szyszka, in the article "Is the Abnormal Post-IPO Under performance Really Abnormal? The Evidence from CEE Emerging Markets," investigate the long-run post-IPO stocks performance and its sources in the Central and Eastern European (CEE) markets. They define the notions of "old" and "young" stocks in terms of the length of time after their IPOs and find that "old stocks" perform significantly better than "young stocks." The age premium is stronger among smaller stocks than among larger stocks when market model is considered as a benchmark; however, this effect and the related abnormal post-issue performance disappear when three- and four-factor asset pricing models are applied.

Barbara Będowska-Sójka, in the article "Liquidity Dynamics Around Jumps: The Evidence from the Warsaw Stock Exchange," conducted microstructural study and investigated the dynamics of trading volume and number of trades around jumps detected in intraday stock returns. She finds that only a minority of jumps is associated with public information releases, whereas the majority of them is motivated by liquidity shocks observed in the spreads, volume, and the number of trades. These results provide evidence that jumps are related to inability of the market to absorb new and big orders. Furthermore, liquidity shocks in volatility, volume, and quoted spread are the key drivers accompanying the occurrence of the jumps at the Warsaw Stock Exchange.

Elżbieta Kubińska, Marcin Czupryna,Łukasz Markiewicz, and Jan Czekaj, in the article "Technical Analysis as a Rational Tool of Decision Making for Professional Traders," find that technical analysis is one of the most popular methods supporting investment decisions of futures market traders and that it is much more popular among futures market traders than among neophyte investors. The concept of processing information was used to explain this phenomenon. They find that neophyte investors are more experiential and intuition-driven while using technical analysis methods to make their decisions, whereas futures market traders are more rationally driven. Moreover, the technical analysis helps professional traders on futures markets, which are less transparent than the regulated stock markets, to process information, and the technical analysis methods are perceived by them as rational, cognitive tools supporting their decision-making processes. The articles selected for publication in this issue of Emerging Markets Finance and Trade, and the many other articles presented and discussed at the "Neoclassical and Behavioral Finance" conference at the University of Łódź, demonstrate the usefulness and the existence of synergies resulting from a combination of the neoclassical and behavioral finance approaches in discussing and explaining the effects observed in financial markets and also in the broader economy. They show that a debate in this area is needed, and that such research meetings greatly help in the exchange of views and empirical experience among finance and economics researchers.

We wish to thank all the participants of the "Neoclassical and Behavioral Finance" conference for their participation and for their research contribution. We also would like to acknowledge help from the institutions that provided assistance to us in the organization of this very successful event in Łódź, in particular the National Bank of Poland (Narodowy Bank Polski), the Financial Sciences Committee of the Polish Academy of Sciences, the Faculty of Economics and Sociology at the University of Łódź, and our other financial sponsors: Atlas, Magellan, and Petecki companies.