Contents

General Introduction 1

I Financial Innovation 7

Introduction 9

1 The Evolutionary Emergence and Vanishing of Assets in Incomplete Financial Markets 17
  1.1 Introduction ........................................... 17
  1.2 Restricted Participation Equilibrium .................. 22
  1.3 Properties of Equilibrium Portfolios ................. 27
  1.4 Evolution under Imitation Rules ..................... 31
  1.5 Mutation ............................................. 34
     1.5.1 Mutation-Stable States .......................... 34
     1.5.2 On-Going Mutation .............................. 37
  1.6 Innovations .......................................... 41
     1.6.1 On-Going Innovation ............................. 43
  1.7 Conclusion ........................................... 45

2 Exploitation via Funds or How Banks Hurt Investors 47

  2.1 Introduction .......................................... 47
  2.2 Model .................................................. 53
     2.2.1 Trading Behavior and Choice of Innovations .... 55
     2.2.2 Equilibria and Prices ............................ 57
  2.3 Impact of Banks on Utilities .......................... 61
     2.3.1 Autarky ......................................... 62
     2.3.2 Economy with one Bank ........................... 63
     2.3.3 Clashing Interests of Banks and Investors ....... 67
II Heterogeneous Expectations

3 Success of the Uninformed - Pure Chance or More? 91
  3.1 Introduction ........................................ 91
  3.2 Model .............................................. 93
    3.2.1 Computation of Equilibrium ................. 96
  3.3 Effects of Accuracy ................................ 97
  3.4 Manipulation ........................................ 105
  3.5 Conclusion .......................................... 107
  3.6 Appendix A (Existence of a Probability Measure \( \tilde{Q} \)) 109
  3.7 Appendix B (Proof of ParetoOptimality) .......... 111

4 Why Rumors have Long-Term Effects on Stock Prices 113

  4.1 Introduction ........................................ 113
  4.2 Model .............................................. 117
    4.2.1 Individual Demand Functions .............. 117
    4.2.2 Price Determination ....................... 121
    4.2.3 Rumors ........................................ 122
  4.3 Properties of the Price Process .................. 123
  4.4 Long-Term Effects .................................. 125
  4.5 Diffusion Independent Results .................... 127
  4.6 Diffusion Processes ................................ 129
    4.6.1 One-Shot Rumor ............................ 130
    4.6.2 Line Rumor .................................. 132
  4.7 Comparison to Empirical Analysis ............... 136
  4.8 Conclusion ......................................... 137
  4.9 Appendix A (Proof of Theorem 10) .............. 140
  4.10 Appendix B (Proof of Theorem 19) ............ 143
CONTENTS

5 How Helpful is a Long Memory on Financial Markets 145

5.1 Introduction ................................................. 145
5.2 Model .................................................... 147
  5.2.1 Portfolio Strategy ..................................... 148
5.3 Trends versus Traditions ............................. 150
  5.3.1 Definition of Equilibrium .......................... 151
  5.3.2 Prices and properties of ard ..................... 153
5.4 Mixed Equilibria ....................................... 157
  5.4.1 Dominant Case ...................................... 159
  5.4.2 Balanced Case ....................................... 160
  5.4.3 Alternating Case ................................... 161
  5.4.4 Half Dominant Case I .............................. 161
  5.4.5 Half Dominant Case II ............................. 165
5.5 Discussion of Mixed Equilibria ................... 167
5.6 Adjustment to Equilibrium ........................... 169
5.7 Predictability of Prices .............................. 173
5.8 Conclusion .............................................. 175
5.9 Appendix A (Strict Monotonicity) ................. 177

6 Hope for Homo Oeconomicus? - On the Evolutionary Fitness of Utility Maximizing Investors 179

6.1 Introduction ................................................. 179
6.2 Model .................................................... 183
6.3 Existence of the Wealth Limit ..................... 188
  6.3.1 Probabilistic Framework ............................ 189
  6.3.2 Construction of the Martingale Measure ........ 189
  6.3.3 Martingale Property of the Relative Wealth Process 191
  6.3.4 Properties of \( \pi \) .................................. 193
6.4 Properties of the Individual Wealth Limit ........ 195
  6.4.1 Constant Wealth Distributions .................. 196
  6.4.2 Single Survivor .................................... 197
6.5 Survival Criteria ....................................... 199
6.6 Conclusion .............................................. 203
6.7 Appendix A (Proof of Lemma 5) ...................... 205
6.8 Appendix B (Proofs of Lemma 6 and Lemma 7) .... 206
6.9 Appendix C (Proof of Lemma 9) ....................... 209
6.10 Appendix D (Proof of Lemma 12) ................. 211
6.11 Appendix E (Proof of Theorem 15) ............... 213
6.12 Appendix F (Proof of Lemma 18) ................. 217
## 7 Evolution of Sophistication

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>7.1</td>
<td>Introduction</td>
<td>219</td>
</tr>
<tr>
<td>7.2</td>
<td>Model</td>
<td>222</td>
</tr>
<tr>
<td>7.2.1</td>
<td>Long-Run Survival</td>
<td>225</td>
</tr>
<tr>
<td>7.2.2</td>
<td>Success of “Always Imitate”</td>
<td>226</td>
</tr>
<tr>
<td>7.2.3</td>
<td>Two Lemmata for Large Economies</td>
<td>231</td>
</tr>
<tr>
<td>7.2.4</td>
<td>Stochastically Stable Sets</td>
<td>232</td>
</tr>
<tr>
<td>7.3</td>
<td>Success of “Imitate if Better”</td>
<td>238</td>
</tr>
<tr>
<td>7.3.1</td>
<td>Stochastically Stable Sets with “Imitate if Better”</td>
<td>241</td>
</tr>
<tr>
<td>7.4</td>
<td>Robustness of Imitation Rules</td>
<td>244</td>
</tr>
<tr>
<td>7.5</td>
<td>Infrequent Learning</td>
<td>245</td>
</tr>
<tr>
<td>7.5.1</td>
<td>Optimal Buying</td>
<td>247</td>
</tr>
<tr>
<td>7.5.2</td>
<td>Optimal Imitating</td>
<td>248</td>
</tr>
<tr>
<td>7.6</td>
<td>Conclusion</td>
<td>253</td>
</tr>
</tbody>
</table>

**General Conclusion**  
257

**Bibliography**  
261