Christoph Kuzmics

Presentation Title

Limit Orders and Knightian Uncertainty
(with Michael Greinecker)

Abstract

Ambiguity averse decision-makers can behave in financial portfolio problems in ways that cannot be rationalized as subjective expected utility maximization. Indeed, [Dow and da Costa Werlang, Econometrica 1992] show that an ambiguity-averse decision-maker might abstain from trading an asset for a wide interval of prices; something no subjective expected utility maximizer can. Dow and da Costa Werlang assume that decision-makers know the price of an asset when trading. We show that when markets operate via limit orders instead, all investment behavior of an ambiguity-averse decision-maker is observationally equivalent to the behavior of a subjective expected utility maximizer with the same risk preferences; ambiguity aversion has no additional explanatory power.

Keywords

Knightian uncertainty; ambiguity aversion; subjective expected utility; financial market participation; strict dominance

Affiliation

University of Graz