

Economic Theory, Decision Theory and Experimental Economics
Seminar

Ambiguous Valuation and Efficiency in Financial Markets

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Abstract

This paper characterizes incompleteness and frictions of financial markets by meaningful features of pricing rules. Financial market imperfections are always related to an ambiguous valuation in the sense that there are many arbitrage-free linear prices consistent with the market. We fully characterize pricing rules of finite financial markets and show that "efficient complete markets with bid-ask spreads" is the prevalent case revealed by pricing rules. On the other hand, incompleteness of financial markets are related to an extreme case of ambiguous valuation.

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