

CALCHAS RESEARCH

A Behavioural-Finance Literature Review and research foundation

Narrative Construction, Conviction and Market Fragility

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Abstract

Economics is often understood as the science of choice, yet financial choices are not produced purely from prices, income, and probabilities alone. They are formed through learned memory, identity, emotion, social environment, and institutional trust, which create the narratives through which people explain the present and imagine the future. This review develops a multi-faceted account of how individual sense-making becomes collective market behaviour. It moves from bounded rationality and decision-making under risk, ambiguity and radical uncertainty, to the cognitive architecture of narratives, the biases that make particular stories persuasive, and the social mechanisms through which beliefs become contagious. Transmitting through herd mentality, common knowledge, and feedback cycles, these narratives affect economic outcomes and asset pricing volatility.

The central discussion is that narratives are neither rigid explanations added after economic decisions nor a substitute for data. They are organising structures that determine which data are noticed, how uncertainty is represented, and which futures feel sufficiently plausible to act upon. Existing work has studied measures of attention, sentiment, uncertainty and social diffusion, but there remains further room for identifying when a narrative has become crowded, structurally fragile or susceptible to market correction. This creates a research opportunity: to combine textual, network and market-distribution measures into a dynamic system that tracks narrative origination, perpetuation, and exhaustion.

From Belief Systems to Science of Choice

Economics was famously defined by Lionel Robbins as “the science of choice” (Robbins, 1932). Yet the apparent simplicity of “choice” can obscure our psychological and social perception of alternatives when decision-making. People do not simply assess markets as optimisation calculatory machines. They interpret them with influence from prior experience, education, institutional and societal norms, and ultimately narratives about how they understand the world around them. These stories do more than communicate information: they organise causality, simplify complexity and comprehend uncertain outcomes into a sequence that feels sufficiently coherent to support action.

This is especially prominent in the field of finance, where many decisions are not made under measurable risk but under uncertainty where the possible outcomes cannot be fully enumerated. A central bank decision, technological transition, geopolitical shock, or speculative asset cycle cannot be reliably encapsulated in a stable set of probabilities. In such conditions, decision-makers require a representation of the situation before they can calculate anything at all. Narratives provide that representation. They create connections and frameworks to conceptualise what has happened, why it happened, what may happen next and what one should do in response.

Robert Shiller’s narrative economics formalises the macroeconomic importance of this process. Popular economic stories spread through conversation, news and social media, shaping expectations and behaviour in ways that can influence economic fluctuations themselves (Shiller, 2017). The relevant question is therefore not simply whether investors possess information, but how that information is selected, framed, socially validated and transmitted into conviction. Market participants respond to economic fundamentals, but such fundamentals are also supported through prevailing causal stories.

This review asks: How are financial narratives cognitively constructed, socially transmitted and translated into measurable market instability? It proceeds from the individual to the social

transmission to collective dynamics. First, it distinguishes expected value, expected utility, bounded rationality, risk, ambiguity and radical uncertainty. Second, it examines narratives as cognitive and conviction structures. Third, it analyses the biases that give stories traction. Fourth, it considers how individual beliefs become shared expectations through information cascades, common knowledge, media and online networks. Finally, it connects those processes to reflexivity, momentum and asset-price deviations. Conclusively, it connects to how cascading feedback loops create tangible changes in the wider economy, linking to the premise of individual psychology being able to spur collective, systemic economic consequences.

Decision-Making Beyond the Fully Rational Agent

Expected value, expected utility and bounded rationality

Narratives can shape individuals' assignment of value to the expected outcomes and understanding of possible futures. Our perception of value attached to an outcome is not determined solely by its objective financial payoff. It is filtered through personal reference points, social expectations, emotional associations, and the wider narrative through which the decision is understood.

Expected value and expected utility are related but distinct. Expected value calculates the estimated monetary outcome of a decision by weighting each possible probability payoff. Expected utility, by contrast, recognises that the same monetary outcome may generate different levels of subjective satisfaction for different individuals. Nevertheless, even though expected utility theory includes more subjective evaluation of choice assessment, it still assumes that individuals have sufficiently stable preferences and consistently assess alternative outcomes. In reality, the utility attached to an outcome is dependent on the individual, especially their framing of identity and social context. Narratives influence which alternative choices appear more desirable, threatening, or socially meaningful. A gain of £1,000, for example, carries different meanings for people in different income brackets. Utility therefore reflects the subjective value attached to an outcome rather than its monetary value alone (Levy et al., 2010).

Assessment of a person's value of outcomes is derived from within the social fabric through which people understand themselves and their relationships. Individuals do not make decisions in complete cognitive isolation. Social comparison, cultural expectations, institutional norms and interpersonal relationships all affect how an outcome is evaluated. Dan Ariely argues that people interpret choices in relation to others and frequently struggle to apply purely economic reasoning when social and market norms operate simultaneously.

Decisions involving friendship, affection, favours or loyalty are governed by different expectations from decisions involving prices, wages and formal exchange (Ariely, 2010).

For example, offering payment for someone else as a favour rather than prioritising self-benefit alters the meaning of the interaction. Once a social relationship is reframed as a market exchange, the individual no longer evaluates the decision solely through affection or reciprocity. The introduction of a price activates a different narrative about obligation and value. This demonstrates that economic value does not exist independently of context: the same action can carry different utility depending on whether it is narrated as generosity, socially appropriate, or commercial exchange (Ariely, 2010).

Behavioral economics does not undermine calculation as a means of decision-making. It highlights critical external and internal forces that could be heavily influencing the actions behind decisions that change prices or even support explanations behind price anomalies. The strategy used depends on the environment and the cognitive resources available. Payne, Bettman and Johnson (1988) found that decision-makers adapt their information-processing strategies to time pressure and task complexity. When a problem becomes more demanding, people frequently use simplifying heuristics rather than exhaustive comparison. This insight links with Herbert Simon's bounded rationality: alternatives are not always given in advance, their consequences are difficult to establish, and decision-makers must search for efficiency and satisfactory choices rather than full assessment of optimal solutions (Simon, 1959). Gary Becker, Nobel Prize winner, notably states that "when studying behavior can no longer be explained according to income or prices, the explanation can be found in the change in tastes" (Becker, 1998, p. 139). Therefore, consumers' continuously changing preferences and "tastes" present the crucial psychological elements that cause changes in economic outcomes, illuminating more in-depth explanations that drive economic changes than purely price metrics.

Risk, ambiguity and radical uncertainty

Assessment of risk is when the outcomes of a situation are uncertain, but their probabilities are known or estimable. Assessment of situations under ambiguity is when probabilities and outcomes are both unknown. Ellsberg's paradox (1961) demonstrated that people often prefer a gamble with known odds in comparison with unknown odds, even when there is no objective reason to expect the ambiguous option to be worse. The distinction matters because many financial decisions presented as "risk" are actually ambiguous, where probabilities are not stably reliable: startup investment, geopolitical positioning, regime change and long-horizon asset allocation all involve probabilities that are unstable, contested or impossible to identify (Ellsberg, 1961).

Neuroeconomic evidence supports a distinction between risk aversion and ambiguity aversion. Levy et al. (2010) show through fMRI scans that subjective value is neurally represented under both risky and ambiguous conditions. However, ambiguity tends to register lower subjective value on outcomes because individuals are not only responding to possible loss but also to uncertainty about the probabilities themselves.

Recent evidence has proven that lived experience has a significant influence on people's ambiguity aversion in situations, and no effect on people's risk aversion. This can be explained by Raio et al. (2022) findings that greater cumulative lifetime stress exposure, especially early-life stress, was associated with stronger ambiguity aversion but not with risk attitudes. This gives empirical weight to a strong point of research: an investor's reluctance to participate may not be explained solely by wealth or abstract risk tolerance. However, it may reflect how prior stress and narratives have reinforced the individual's adaptability to face decisions with unknown probabilities, as opposed to known probabilities, when faced with uncertain outcomes.

The concept of radical uncertainty goes further. In these settings, outcomes cannot be comprehensively listed, and probabilities cannot meaningfully be assigned. Conviction

Narrative Theory argues that narratives become the “currency of thought” under these conditions because they organise causal, temporal, analogical and emotional information into a structure that permits explanation, simulation and action (Johnson, Bilovich and Tuckett, 2023). The narrative does not eliminate uncertainty. It creates enough subjective coherence for a person or organisation to act despite it.

The Cognitive Architecture of Narratives

Narratives as temporal and causal models

Narratives allow experience to be ordered through time and create causality. They compress otherwise fragmented information into manageable units, or “chunks,” that can be retained and retrieved more easily (Miller, 1956). Narrative comprehension also involves generating causal inferences, linking goals to actions and predicting consequences (Graesser, Singer and Trabasso, 1994; Pennington and Hastie, 1993; Mar, 2004). In financial settings, a narrative therefore does not merely state that inflation is high or that an asset price is rising. It supplies a plot: inflation is persistent; the central bank will respond; financing conditions will tighten; particular assets will suffer or benefit.

This is why two investors can observe the same data and form opposing opinions. They may agree on the facts but attribute those facts to different causal models. For example, a rate cut could be interpreted as evidence of policy support; another interprets it as a signal that the economy is slowing down. The difference is not simply optimism versus pessimism. It is a difference in the narrative architecture connecting policy, growth, liquidity and future prices.

Prediction, pattern recognition and prior experience

Predictive-processing accounts propose that the brain continuously uses prior experience to generate expectations about incoming information (Clark, 2013; Friston, 2003). Pattern recognition therefore tends to carry an implied causal history and a forecast. When an investor identifies a chart as a “breakout,” a company as “the next platform,” or a currency as “losing credibility,” the label contains an anticipated future path.

This predictive capacity is adaptive. It allows rapid action in complex environments. Yet it also makes narrative perception vulnerable to confirmation bias: when a belief or pattern is identified, our brains often seek out ambiguous evidence in our environment or surroundings to prove that the pattern is real. The issue is not that the brain fabricates stories irrationally in

every case. It is that a system that creates subconscious causations can reinforce belief systems or mental biases that were once formed.

“The Profiteer”

Our self-concepts strongly shape how we understand ourselves and our position within the economy. They are not formed independently, but emerge through continuous interaction between internal psychological and neural processes and our social environments. Individuals repeatedly assess their self-worth relative to others, developing narratives about who they believe they are, what they are capable of achieving, and which economic or professional roles they should aspire towards. These identity-based narratives can influence attitudes toward work, income, consumption, investment, and ambition. Employment is therefore not valued solely through financial compensation: occupations can also provide status, purpose, social recognition, and confirmation of a desired identity (Akerlof and Kranton, 2010). Narratives of ambition, entrepreneurship, wealth, and subjective success can consequently motivate productive action, but they can also spread socially as aspirational trends that redefine what individuals believe they should become. Shiller similarly argues that people may treat narratives as behavioural scripts, particularly under uncertainty, allowing socially transmitted stories to influence both identity and economic conduct (Shiller, 2017).

The historical spread of the word “profiteer” illustrates how such identity-based narratives can develop into collective economic behaviour. The term did not originally describe an explorer or ordinary marketer; rather, it referred to someone believed to be making excessive or morally illegitimate profits, particularly during wartime. According to Shiller, the Oxford English Dictionary records its first use in 1912, although the term became widely contagious during and immediately after the First World War. The word also echoed the older term privateer, giving it associations with exploitation and opportunistic enrichment at the expense of society. During this period, the U.S. retail price index, later incorporated into the Consumer Price Index, rose from a base value of 10 in 1913 to 20 in 1920. Importantly, the “profiteer” narrative did not itself cause this initial increase in prices. Rather, the post-war rise in prices was

increasingly blamed on supposed profiteers, who became socially constructed villains within the prevailing economic narrative (Shiller, 2017).

This moral framing subsequently influenced consumer behaviour. People were encouraged to view purchasing expensive goods as exploitation, while thrift and refusal to pay “war prices” became signs of moral responsibility. Consumers boycotted high-priced products and postponed discretionary purchases because they expected prices to return to their idealised 1913 levels. These individually rational attempts to wait for lower prices became collectively contractionary: when large numbers of consumers delayed spending simultaneously, demand weakened, and the economic downturn intensified. Shiller therefore proposes that the deflationary recession of 1920-1921 may be fairly influenced by narrative-driven consumer boycott reluctance to spend and expectations of deflation, and a desire to outmanoeuvre sellers reinforced one another (Shiller, 2017).

The key argument is: Narratives can first shape identity and value judgment, which then enables these judgments to influence economic behaviour at the collective level.

The “profiteer” case is powerful because a single emotionally charged label changed how consumers interpreted prices, sellers, thrift, and their own role in the economy. In the figure below, Shiller’s paper supports this interpretation by showing a sharp increase in the frequency of the word around 1920, followed by a gradual decline as the narrative lost its contagious force.

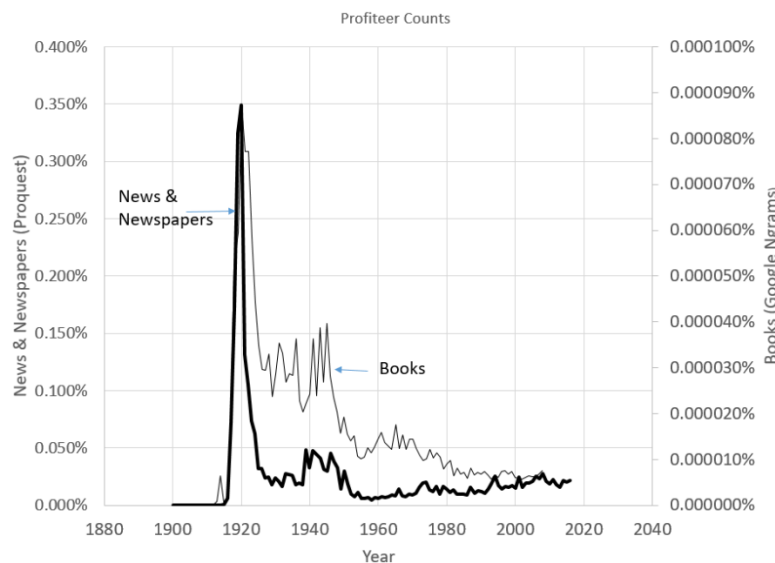


Figure 5. Frequency of appearance of word “profiteer” by year. For news and newspapers (1900-2016, from Proquest) it is the number of articles with this phrase as a percent of all articles that year. For books (1900-2008, from Google Ngrams) it is the number of occurrences of the phrase divided by the total number of words in the database for that year, in percent.

Figure 1. Frequency of the term “profiteer” across media sources, illustrating the proliferation of language that circulates shared meaning throughout a community and reinforces negative connotations within the economic sphere (Shiller, 2017).

Conviction narratives and the transition from belief to action

Tuckett and Nikolic (2017) describe conviction narratives as structures that allow people to identify opportunities, simulate outcomes and feel secure in creating goals and then actions under radical uncertainty. Johnson, Bilovich and Tuckett (2023) refine the framework around four connected processes: explanation, simulation, affective evaluation and communication. A financial narrative becomes implemented through action when it explains the situation, elicits an imaginable future, attaches emotional value to that future and can be communicated to others (Johnson, Bilovich and Tuckett, 2023).

This distinction between an ordinary narrative and a conviction narrative is central. There are numerous cases where market stories circulate without changing behaviour. A conviction narrative attaches a causal plot to an emotional and strategic commitment, translating “this situation may happen” into “this situation is the opportunity or threat on which I am prepared to act” (Tuckett and Nikolic, 2017; Johnson, Bilovich and Tuckett, 2023). The stronger the

emotional investment and social reinforcement, the more difficult the narrative may be to revise and change. In an example, a patient may be more likely to accept a doctor's advice when the diagnosis aligns with their existing understanding of the illness and socially reinforced expertise; more closely, making the patient believe the treatment is congruent with their experienced symptoms (Tuckett and Nikolic, 2017).

Narratives can therefore be understood as uncertainty-management devices. They do not necessarily increase objective knowledge, but they reduce the felt uncertainty or disorder of the decision environment (Tuckett and Nikolic, 2017). This helps explain why coherent but weakly evidenced stories can outperform nuanced analysis in attracting attention and capital. A simple narrative can coordinate action precisely because it suppresses complexity. That capacity is productive during origination, but dangerous at saturation, when the same simplification prevents recognition of changing conditions.

Psychological Mechanisms That Give Narratives Traction

Prospect theory, reference points and loss aversion

Kahneman and Tversky's (1979) prospect theory challenged the assumption that people evaluate wealth states and loss and gain symmetrically. They contest that outcomes are fixed relative to a reference point: losses generally carry more weight than equivalent gains, and risk preferences can be biased in outlook towards minimisation of loss rather than incurring gains. People tend to become more risk-seeking when attempting to avoid a sure loss (Earl, 1990, p.724).

Narratives determine where the reference point is placed. A company that reports "12% market share" may be framed as a growing challenger relative to last year's 10%, or as a declining report relative to a prior peak of 15%. The number is unchanged; the narrative converts it into a gain or a loss. In markets, the purchase price, past highs, analyst target, inflation regime, or peer performance can all become anchors against which outcomes are psychologically coded or bolstered in media, conversations, or collectively upheld normative values.

The greater regard for loss aversion extends beyond choice to confidence. Lebreton et al. (2019) found significantly greater confidence in persons when task context framed their objective to seek gains rather than avoid losses, despite similar task performance. The mere context aim to "seek gains" altered a person's confidence within the task setting, while "avoid loss" created a confidence dip in performance suddenly. Outcome valence can therefore bias the subjective certainty attached to a decision, not merely the utility of the outcome (Lebreton et al., 2019). This is highly relevant to market narratives: a loss-framed environment can reduce confidence, promote defensive positioning or, under pressure to recover, trigger escalation of risk.

Framing, anchoring and confirmation

Framing changes behaviour by changing the representation of an otherwise similar decision (Tversky and Kahneman, 1981). Media and political institutions are therefore not neutral transmitters of economic information. They are context framing architects. Describing inflation as “temporary price pressure,” “a cost-of-living crisis” or “currency debasement” activates different causal explanations, emotional responses and policy expectations.

Anchoring compounds this effect. Initial values or interpretations exert a persistent influence even after new information becomes apparent. In finance, past prices, consensus forecasts, and familiar regimes act as anchors to previous norms established for metrics. The confirmation bias effect filters subsequent information in favour of the established narrative, where the brain views the world through lenses to confirm upheld beliefs. On the other hand, cognitive dissonance makes contradictory evidence psychologically costly, which prevents people from following their values or intended thinking (Festinger, 1957). The combined effect is not simple ignorance. It is a self-protective process in which the decision-maker preserves coherence by reinterpreting evidence that threatens identity, competence, or prior commitment.

Availability further amplifies vivid risks. Goetzmann, Kim and Shiller (2016) found that investors’ perceived probabilities of a severe market crash were substantially higher than historical base rates and were consistent with media-driven availability effects. A vivid narrative can therefore shift believed probability or fundamentals without changing the underlying distribution of outcomes.

Experience, identity and social comparison

Economic preferences are not fixed outside history. Malmendier and Nagel (2011) show that individuals’ lifetime experiences of stock and bond returns affect willingness to take financial risk and market expectations. Personal experience provides the raw material from which future narratives are constructed (Malmendier and Nagel, 2011). A person shaped by crisis

may interpret volatility as the beginning of collapse; someone shaped by sustained growth may treat the same volatility as an opportunity to profit.

Identity and social comparison also matter. People tend to evaluate their own success, competence, and status relative to others. Within a community, visible gains, consumption, and investment success can influence others to participate in markets and encourage similar behaviors. Akçay and Hirshleifer (2021) place such mechanisms within “social finance,” where transmission bias, networks, institutional settings and psychological traits jointly influence market dynamics (Akçay and Hirshleifer, 2021). Consequently, what appears to be an individual preference may partly be a socially learned response to what is visible, admired and repeatedly narrated.

From Individual Bias to Collective Belief

Herding and informational cascades

When people observe the actions of others, they may rationally infer that those actions represent crucial information about current market performance and expectations. Yet this can produce informational cascades in which later participants disregard their own private signals or information and imitate earlier decisions or the crowd (Bikhchandani, Hirshleifer and Welch, 1992). Cascades can become large based on limited initial and popularised information and can also reverse sharply following a small public shock. This provides a bridge between individual uncertainty and the fragility of collective, mass behaviour.

Herd mentality is therefore not sufficiently described as people thoughtlessly “following the crowd.” It may begin as an attempt to learn from others. The instability emerges because observable actions conceal the root evidence and quality of the information supporting these motivations. A price rise can be interpreted as evidence of superior private knowledge even when it was generated by previous imitation from other people following one another’s actions and information.

Common knowledge and higher-order expectations

Financial markets depend not only on first-order beliefs about value but on higher-order beliefs about what others believe. Keynes’s beauty-contest analogy captures the conflict: investors devote intelligence to anticipating “what average opinion expects average opinion to be.” Public statements from central banks, governments and influential media outlets matter because they can create common knowledge - information that everyone knows and knows that others know (Hunt, 2013).

Morris and Shin (2002) formalise how public information can coordinate expectations. Public signals may receive disproportionate weight because they help agents predict one another, not necessarily because they are more accurate than private information. This provides an

academic foundation for Epsilon Theory: a market-moving statement is powerful partly because it changes the game of collective anticipation of public opinion, which creates second, third, fourth degrees of thinking about the collective consensus (Morris and Shin, 2002). Built upon common knowledge, the pool of interpretations of common thinking proliferates and influences people's behaviors based on others' predicted behaviors. The event and the narrative of the event cannot be cleanly separated.

This leads to a shift in the relevant question. Markets do not ask only, "What is based on reality, or straying from fundamentals?" They also ask, "What will everyone collectively believe is true, and how will they act on that belief?" The resulting price can be rational with respect to the coordination game while still departing from a fundamental valuation model.

Media, policy uncertainty and attention

Shiller (2017) treats contagious narratives as economic epidemics. Their transmission depends on emotional resonance, repetition, mutation and social relevance. News intensity can therefore become a major influencer within the economic environment rather than merely a report on it.

Baker, Bloom and Davis (2016) operationalise one dimension of this environment through the Economic Policy Uncertainty Index, constructed from newspaper coverage, tax-code expirations and forecast disagreement that spikes in policy uncertainty in the United States and United Kingdom correlate strongly with increases in higher anxiety-driven words in online news articles (Shiller, 2017, p. 994). Nyman et al. (2021) similarly apply algorithmic text analysis to financial-market narratives and find that emotional content is correlated across sources, with unusually high excitement relative to anxiety building before the global financial crisis and then collapsing (Nyman et al., 2021).

Online platforms compress the transmission process further. Semenova and Winkler (2021, 2025) examine, through Reddit chains on WallStreetBets discussions: hype-driven sentiment

and attention can become a cycle of self-reinforcing market exuberance, retail demand follows online discussion, and viral content can amplify the market impact of idiosyncratic beliefs. Empirical evidence shows that users exposed to bearish content are significantly more likely, by nearly 50%, to adopt similar views. Analysis of heavily discussed stocks proved to significantly increase future investor attention and engagement (Semenova and Winkler, 2021). Through reflective dynamics: heightened attention fuels demand and rising prices, which in turn validate and amplify the underlying narrative. Social media does not merely accelerate information. It changes which information becomes popularised, how quickly social proof accumulates and how visibly conviction is executed.

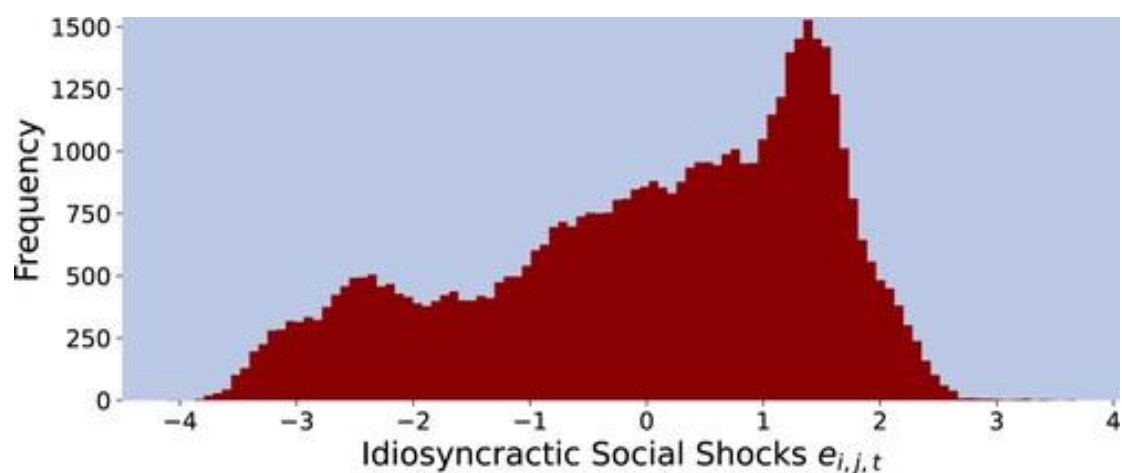


Figure 2. Distribution of idiosyncratic (unusual) social shocks, graphing heterogeneity in investor sentiment that strays from common market information and variation amplified by social beliefs (Semenova and Winkler, 2021).

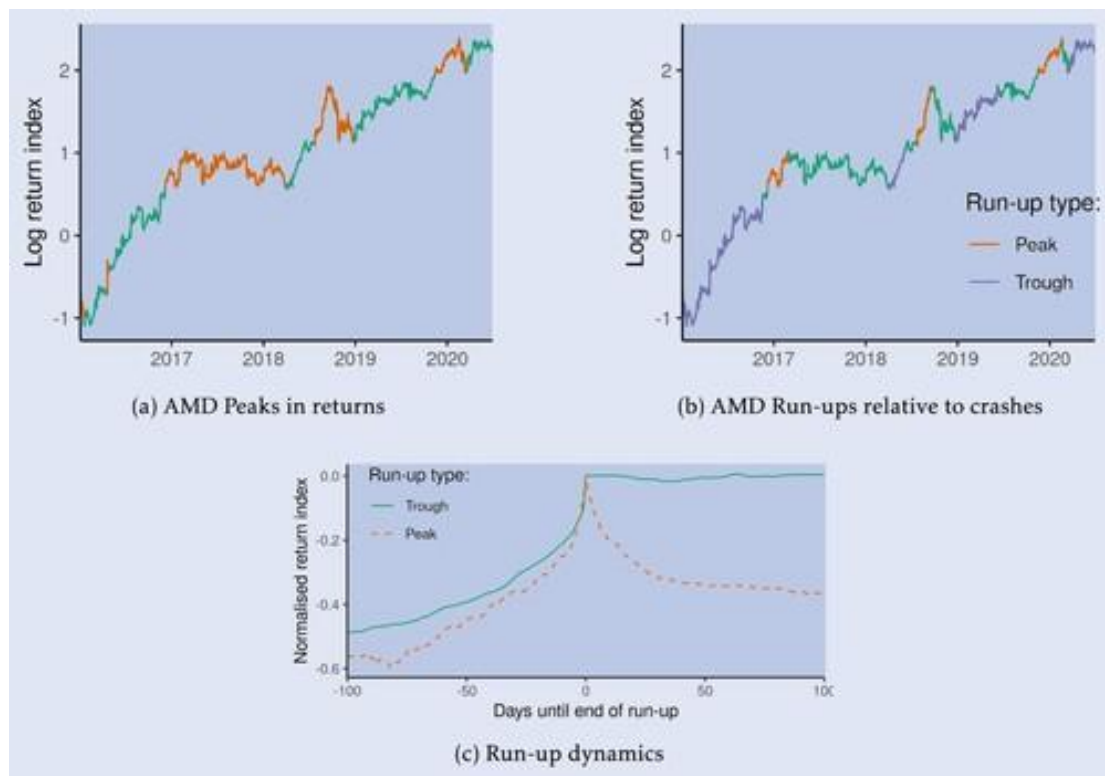


Figure 3. Price run-ups to mark over-hype sentiment drive prices upwards through Advanced Micro Devices (Semenova and Winkler, 2021).

Reflexivity, Animal Spirits and Endogenous Price Dynamics

Reflexivity: when perception changes the object perceived

Soros's theory of reflexivity argues that market participants' biased perceptions can create positive or negative feedback loops in society, where self-reinforcing momentum can bolster people's beliefs, narratives, and mental models. Rising asset prices and improved collateral attract attention and can lower perceived risk and validate the hyped narrative that caused the buying. The feedback loop can therefore move prices and alter underlying economic conditions together (Umpleby, 2018). This is more than a misperception of reality: the act of overly positive or excessive financial behavior can create asset bubbles that stray from fundamental value due to people continually reaffirming each other's beliefs fueled by market sentiment and exaggerated expectations.

Reflexivity clarifies why a narrative can appear increasingly "true" during propagation. Price confirmation attracts more participants; participation strengthens flows; flows raise prices; and rising prices are interpreted as evidence that the original story was correct. The narrative is not validated independently of the market. It is validated by a cycle of reinforcing momentum of such attention upwards and popularised ideology.

Animal spirits and confidence as a macroeconomic force

Akerlof and Shiller (2009) extend Keynes by treating confidence, fairness, corruption, money illusion and stories as constitutive features of macroeconomic behaviour. Confidence can function like a multiplier: optimism supports spending and investment, while pessimism suppresses activity before the feared outcome is fully realised. Safe assets can consequently carry a psychological premium during periods of uncertainty because they offer institutionalised certainty, not merely a favourable expected return (Akerlof and Shiller, 2009).

Institutional trust moderates this mechanism by influencing investors' beliefs about the safety and legitimacy of market participation. Guiso, Sapienza and Zingales (2008) show that lower trust reduces stock-market participation because investors attach greater weight to the possibility of being cheated. Trust therefore affects more than an investor's predicted return volatility; it influences their confidence in the institutions, intermediaries and rules through which those returns are generated. A market narrative is consequently embedded within wider beliefs about institutional credibility, enforcement, and fairness. Even an attractive investment story may fail to generate participation if investors distrust the institutions supporting it. Conversely, strong institutional trust can strengthen conviction by reducing perceived uncertainty around fair market operations. When trust deteriorates, investors may demand a higher risk premium, shift toward assets perceived as safer, or withdraw from the market, allowing changing institutional narratives to translate into altered financial behaviour (Guiso, Sapienza and Zingales, 2008).

Underreaction, momentum and overreaction

Behavioral asset-pricing research provides a mechanism through which narrative diffusion can create predictable price dynamics. Hong and Stein (1999) model “newswatchers,” who receive information gradually, and momentum traders, who respond to previous price changes. Slow information diffusion can initially generate underreaction, creating arbitrage or opportunity for momentum profit (Hong and Stein, 1999). Momentum participation then extends the trend beyond the information content of the original news, producing eventual overreaction and reversal.

Empirical work supports distinct short- and long-horizon effects. Chan, Jegadeesh, and Lakonishok (1996) show that past returns and earnings news contain separate information about subsequent returns, while De Bondt and Thaler (1985) found that extreme past winners tended to underperform over longer periods, while extreme losers often recovered. This suggests that investors can initially underreact to information, subsequently become excessively optimistic or pessimistic, and later reverse once prices have moved too far from

fundamentals. Strong positive returns may be momentarily overlooked and have a delayed response to information: Li (2008) offers one possible explanation for this underreaction through wording and connotations of annual reports. This supports that firms experiencing losses or transitory earnings tend to produce longer and less readable annual reports. The cushioned communication of losses is construed in a way to be not so blatantly clear. Under Bloomfield's (2002) incomplete revelation hypothesis, complex communication increases the full understanding or analysis of bad news and may therefore delay its incorporation into market prices. Bloomfield (2008), however, cautions that such complexity may also arise because unusual losses are inherently more difficult to explain, or because of attribution, litigation, and disclosure requirements (Bloomfield, 2008).

Once the market has only partially reacted to new information, the resulting price trend can attract further buying. Investors may interpret continued gains as confirmation that the prevailing narrative is correct, while momentum traders often buy because of increasing prices. This additional demand can eventually push the price beyond what the reality of information justifies, transforming initial underreaction into later overreaction. De Bondt and Thaler's (1985) evidence of long-run reversal suggests that this self-confirming process can eventually push valuations beyond their fundamental justification. A similar dynamic was visible before the 2008 financial crisis: complex mortgage structures made deteriorating loan quality costly to evaluate, while rising property prices, strong short-term returns and continued institutional participation offered simpler and more visible signals of safety. The market therefore underreacted to contradictory fundamental information while overreacting to its own previous success, until defaults exposed the fragility of the dominant narrative (Bloomfield, 2008). This also represents cognitive dissonance effects of the mass population for their propensity to ignore contradictory information, to uphold past beliefs or feelings of "success" to prevent the mental toll of being proven wrong (Festinger, 1957).

Conclusion

This review has traced a pathway from individual cognition to systemic market behaviour. Under structured risk, expected utility provides a coherent benchmark. Under ambiguity and radical uncertainty, decision-makers construct representations and narratives of situations. Narratives perform that function by connecting events through time, causality and emotion. They allow people to imagine futures, establish reference points, and take action without completely knowing probability distributions.

The same cognitive process that enables action also creates susceptibility to influence and altering perceptions. Loss aversion, framing, anchoring, and confirmation bias can subconsciously uphold previously ingrained narratives and prevent revision of beliefs. Additionally, social learning and common knowledge can influence private interpretations into collective expectations. Media and online networks accelerate transmission and can change prices and impressions of market expectations, contributing to reflexive loops in which beliefs appear to validate each other and amplify. Underreaction can invite momentum; momentum can become overreaction; and the eventual re-correction to fundamental, real valuations can illuminate the major narrative structures that coordinated such hype-driven, divergent trade.

The literature is increasingly capable of measuring sentiment, attention, uncertainty and diffusion. It is less capable of identifying the architecture of conviction and the moment at which a narrative becomes saturated. Its strongest contribution would not be another undifferentiated sentiment index, nor a claim to determine whether a story is objectively true. It would be a disciplined system for estimating narrative state and fragility: how a story originates, how it mutates, who validates it, when price action becomes self-referential, and how vulnerable the collective belief structure is to breakdown. In that sense, the central behavioural-finance opportunity is not merely to identify irrationality. It is to gain critical evaluation skills and models to understand coordinated market instability periods before they

exacerbate market values past reality. Such greater integration of psychology into finance provides opportunities to illuminate essential pathways of reasoning behind market behaviours that ultimately operate the very fabric of our economy and businesses.

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