

# **The Adaptive Markets Hypothesis: Reconciling Behavior and Rationality via Evolution and Biology**

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## **Abstract:**

Rational economic behavior in which individuals maximize their own self-interest is only one of many behaviors that can arise from natural selection. In a simple binary choice model in which behaviors linked to reproductive success will survive and less successful behaviors will disappear exponentially fast, I derive a single evolutionary explanation for the origin of several behaviors including risk-sensitive foraging, risk aversion, loss aversion, probability matching, randomization, and diversification. The key is the impact of behavior in a given environment on reproductive success. This framework, called the Adaptive Markets Hypothesis, shows that the Efficient Markets Hypothesis is not wrong, but merely incomplete.