

## Financial Entropy: The Degree of Disorder, Randomness and Unpredictability

*Finansal Entropi: Düzensizlik, Rastgelelik ve Öngörülemezlik Ölçüsü*

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## Öz

Finansal entropi kavramı, çeşitli iç ve dış faktörlerin etkisi altında finansal piyasalardaki belirsizlik, düzensizlik ve risk derecesini ifade etmektedir. Finansal entropi, yüksek düzeyde oynaklık, belirsizlik, risk, karmaşıklık, bulaşma riski ve piyasa verimsizliği gibi çok sayıda sonuca sahiptir. Finansal entropi kavramının anlaşılması, yatırımlarla ilişkili potansiyel getiriler ve riskler hakkında değerli bilgiler sağladığından finansal analistler ve yatırımcılar için büyük önem taşımaktadır. Finansal entropinin etkin bir şekilde yönetilmesi, piyasa koşullarına titizlikle dikkat edilmesini ve finansal piyasalarla ilişkili getiri ve risklerin kapsamlı bir şekilde anlaşılmasını gerektirir. Finansal entropiyi ölçmek için rassal yürüyüş teorisi, gürültü, entropi endeksi, entropi tabanlı risk ölçüsü, Shannon entropisi, Tsallis entropisi ve Rényi entropisi gibi çok sayıda teori ve teknik geliştirilmiştir. Çalışma 'finansal entropinin kuantum analogisi' kavramını araştırmakta ve piyasa katılımcılarının genel davranışları hakkında fikir edinmek ve finansal piyasaların belirsizliğini ve öngörülemezliğini açıklığa kavuşturmak için kuantum mekaniği ile finansal entropi arasında bir karşılaştırma önermektedir. Bu ilkeler, finansal entropiyi etkin bir şekilde yönetmek için finansal piyasa koşullarını düzenli olarak izlemenin ve stratejileri buna göre ayarlamının önemini vurgulamaktadır.

**Anahtar Kelimeler:** Entropi, Ekonofizik, Finansal Entropi

## Abstract

The notion of financial entropy refers to the degree of unpredictability, disorder, and risk in financial markets under the influence of various internal and external factors. Financial entropy possesses numerous consequences, including an elevated level of volatility, uncertainty, risk, complexity, contagion risk, and market inefficiency. Understanding the concept of financial entropy holds significant importance for financial analysts and traders as it provides valuable insights into the potential returns and risks associated with investments. The effective management of financial entropy necessitates meticulous attention to market conditions and a comprehensive comprehension of the motives and risks associated with financial markets. Numerous theories and techniques have been developed to quantify financial entropy, including random walk theory, noise, entropy index, entropy-based risk measure, Shannon entropy, Tsallis entropy, and Rényi entropy. The study explores the notion of the 'quantum analogy of financial entropy' and proposes a comparison between quantum mechanics and financial entropy to gain insight into the general behavior of market participants and clarify the uncertainty and unpredictability of financial markets. These principles emphasize the significance of regularly monitoring financial market conditions and adjusting strategies accordingly to effectively manage financial entropy.

**Keywords:** Entropy, Econophysics, Financial Entropy.

## Introduction

The main research work of this paper includes the following: (1) the key aspects of financial entropy, impacts on the financial systems, financial markets, and instruments, (2) setting up a quantum analogy for financial entropy. This study can provide a new perspective for understanding complexity in the financial system and comparing the motion of prices resembling to the characteristic of quantum particles, superposition, entanglement, and contiguity. This study contributes to the field of financial systems research by providing a comprehensive analysis of the factors shaping financial entropy and theoretical evidence inspiring various theories.

Financial entropy refers to the degree of disorder, unpredictability and risk in financial markets caused by internal and external factors. The aforementioned concept pertains to the degree of deviation of financial markets from anticipated levels over time and is a relatively recent concept that is still being explored within the financial industry. The concept of financial entropy pertains to the intricate and unpredictable nature of financial markets, which are characterized by randomness,

irregularities, noise, and unanticipated events that have the potential to impact prices and returns. The notion is founded on the notion that financial markets are susceptible to multiple influences, resulting in irregular fluctuations that are challenging to predict. 'Rising entropy indicates more financial disorder.' (Cockshott and Zachariah, 2014: 41) To comprehend the concept of financial entropy, it is recommended to utilize the thermodynamic concept of entropy. Rudolf Clausius first introduced the concept of entropy in 1854 in his work 'Theory of Thermodynamics'. Clausius defined entropy as a measure of the energy of a system that cannot be converted into an output, as well as a measure of disorder in the system. He utilized the concept of entropy to explicate the reason why heat is consistently transferred from hot to cold objects and certain processes, such as energy dissipation, cannot be reversed. This concept gained recognition as the second law of thermodynamics and has been utilized in a diverse range of disciplines, including statistical mechanics, quantum mechanics, and thermodynamics.

In 1948, Claude Ellwood Shannon proposed the notion of entropy in his work 'Mathematical Theory of Communication'. 'Later Shannon (1948) showed that the entropy notion can be applied in areas of science where probabilities can be determined.' (Deeva, 2017: 1889) Shannon demonstrated that the concept of entropy can be applied to communication systems, where probabilities can be determined through statistical analysis. Later, scientists discovered that entropy could be applied to many areas of science, including information theory, statistical mechanics, and thermodynamics. In Shannon's information theory, entropy is an indicator of the degree of uncertainty or disorder in a system. The degree of randomness and unpredictability of market movements can also be considered as entropy in financial markets. 'His work may remind us about path dependency in economics, which is often said to be the reason why economic activities cannot be described by a universal theory.' (Chen, 2011: 5)

'Although the word entropy was originally used in thermodynamics, its notions, and relevant principles have been applied to the field of finance for a long period of time' (Zhou and Tong, 2013: 4926) The notion of financial entropy originated in the 1960s, and several methods have been developed to calculate it, including Shannon entropy, Salis entropy, and Rényi entropy. These instruments are utilized to quantify the degree of risk and uncertainty in financial markets and are utilized in a diverse range of financial applications. For a considerable period of time, financial researchers and analysts have been captivated by the concept of financial entropy, as it provides a valuable instrument for comprehending and quantifying the uncertainty prevalent in financial markets. By comprehending the degree of financial entropy in a specific market, financial analysts and traders can enhance their capacity to make informed predictions about future market trends and devise more efficacious risk management and portfolio strategies. 'An alternative way to study stock market volatility is by applying concepts of physics which significant literature has already proven to be helpful in describing financial or economic problems, such as, the concept of entropy. Although there are many different understandings of this notion the most commonly used in literature is as

a measure of ignorance, disorder, uncertainty or even lack of information' (Bentes and Menezes, 2012, 3) It is essential to comprehend financial entropy within the context of market efficiency. Several market participants hold the belief that financial markets are efficient, implying that all pertinent information is incorporated into market prices. Nonetheless, certain individuals contend that financial markets exhibit inefficiency owing to the existence of financial entropy, the presence of irrational investors, and other internal and external factors that may contribute to market instability and uncertainty.

'The debate on what drives the predictability continues. It may reflect irrational investor behavior and hence be exploitable in trading strategies' (Ang and Bekaert, 2001, 1) Financial entropy is an important tool for investors because it involves the use of advanced mathematical and statistical techniques to analyze financial data, identify patterns and relationships, and estimate the risk and return characteristics of an investment portfolio. By utilizing financial entropy, investors can make informed decisions regarding their investments and devise efficient investment strategies. It can also be utilized to predict future market movements and evaluate a company's financial position.

In the realm of financial entropy, the real value of a financial instrument encompasses both the anticipated value and any unanticipated value. This unforeseen value is frequently referred to as 'alpha' and is frequently the outcome of market fluctuations and other external factors. Understanding alpha is of utmost importance in investment decisions as it provides valuable insights into an instrument's true potential. Nonetheless, it is crucial to bear in mind that the fair value of a financial instrument is ultimately determined by the collective behaviors of financial market participants, which may be affected by a variety of unforeseeable factors.

$$\text{Real Value} = \text{Predicted Value} \pm \text{Unpredicted Value} \quad (1)$$

Assuming that the formula predicting the value of a financial instrument is as follows.

$$y = x \quad (2)$$

Then, the formula for the real value of the financial instrument is as follows.

$$y^r = x \pm \alpha \quad (3)$$

$$\alpha > 0 \text{ or } \alpha < 0 \text{ not } \alpha \neq 0$$

Alpha ( $\alpha$ ) represents an unexpected value or deviation of the real value from the predicted value. In the context of financial entropy, it is the degree of randomness and uncertainty in financial markets that can cause prices and returns to deviate from expected values. The alpha value can be positive or negative, indicating that the real value of the financial instrument is either higher or lower than the anticipated value. The significance of unpredictability (also known as

alpha) is recognized in investment decisions as it provides valuable insights into the potential returns and risks associated with an investment. The rationale behind the utilization of the term ‘alpha’ can be elucidated as follows:

*Randomness:* ‘In general, randomness is defined as the lack of patterns.’ (Delgado-Bonal, 2019: 1) ‘Randomness stems from our incomplete knowledge of reality, from the lack of information which forbids a perfect prediction of the future. Randomness arises from complexity, from the fact that causes are diverse, that tiny perturbations may result in large effects.’ (Bouchaud and Potters, 2003: 1). Randomness is a key element of financial entropy because it reflects the degree of unpredictability and uncertainty in financial markets. The aforementioned phenomenon is characterized by unforeseen occurrences that have the potential to impact the valuation of a financial instrument and its return on investment. Randomness has the potential to result in market inefficiencies and suboptimal outcomes, ultimately leading to financial entropy. For instance, unanticipated news or events may trigger market panic, resulting in a divergence in the price of a financial instrument from its fundamental value. Randomness has the potential to induce excessive risk-taking and speculation, thereby enhancing the likelihood of financial entropy. ‘Endogenous fluctuations due to finite-size effects and external news (noise) seem to be needed to retrieve the observed randomness of stock market prices’ (Sornette, 2003: 46).

*Level of Error:* ‘This valuation measure’s accuracy is critical, as it influences subsequent decisions within the market chain. However, measurement errors often arise due to inherent uncertainties in the value state, impacting economic agents’ wealth, particularly when trading significant commodities’ (Özdilek, 2023, 1) To measure the deviation between the real entropy of a financial system and its estimated value, the degree of financial entropy error must be taken into account. Errors and biases in the creation of financial models and forecasts have the potential to impact the precision of financial data. The process of calculating the error involves subtracting the real entropy from the estimated value, and it is typically expressed as a percentage to indicate the precision of the model employed. The utilization of more precise models or data of superior quality can be employed to mitigate errors in the realm of financial entropy. Moreover, enhancing the quality of data and employing more effective algorithms can aid in reducing the degree of economic entropy.

*Irrationality:* ‘The classic paradigm of financial theory assumes that investors operating in frictionless markets make rational decisions. Under this paradigm, rational investors set prices, and their actions lead to the elimination of dominated financial investments’ (Elton et al., 2002, 1) The notion of irrationality is an important aspect of financial entropy because it indicates the extent to which market participants deviate from rational decision-making based on emotions, biases, and other irrational influences. In the financial sector, irrationality has the potential to result in booms crashes, resonances, and various other forms of systemic risk. The investigation of irrationality in financial entropy has been extensively studied, particularly in the field of behavioral finance. Research conducted in this field has revealed that investors frequently make decisions that

result in excessive risk-taking or risk aversion, exhibiting an overly optimistic outlook during periods of high volatility and a pessimistic outlook during periods of low volatility.

### 1. Implications of Financial Entropy

Financial entropy has various implications for financial markets, such as volatility, uncertainty, risk, complexity, contagion risk, and market inefficiency. As the degree of financial entropy increases, the financial system becomes increasingly unstable and unpredictable, resulting in a variety of adverse effects on financial markets, including volatility, uncertainty, risk, complexity, contagion and market inefficiency.

*Increased Volatility:* The statistical measure of volatility is used to evaluate the rate of change in results over time. It is associated with the notions of randomness, risk, and uncertainty, all of which are manifestations of entropy. Financial entropy has the potential to result in heightened volatility in financial markets. When there exists a significant level of disorder and unpredictability, it becomes challenging to forecast the behavior of financial instruments such as stocks, bonds, and currencies, as well as the degree of financial markets. This phenomenon has the potential to result in unanticipated fluctuations in prices and elevate the probability of financial loss for investors.

*Increased Uncertainty:* 'Most economic analysis of choice under uncertainty, and particularly of increases in uncertainty, has been based on the assumption that decision-makers have well-defined subjective probabilities' (Grant and Quiggin, 2004, 18) As the financial system becomes more uncertain and unstable, investors may become more cautious and avoid taking risks. This phenomenon has the potential to exacerbate market volatility, wherein prices undergo rapid and abrupt changes.

*Increased Risk:* 'Entropy has its unique advantages in measuring risk and describing distributions.' (Zhou and Tong, 2013: 4926) Financial entropy increases the degree of risk in financial markets, making it difficult for investors to assess the current or future value of financial instruments. This may result in more volatile market conditions that may prove challenging for investors to manage. Consequently, certain investors may opt to reduce their market holdings or employ risk management strategies to mitigate the potential impact of elevated volatility. 'The entropy produces more exact and stable measure of risk and should be implemented and assessed by practitioners in their investment decisions.' (Deeva, 2017: 1892)

*Increased Complexity:* 'The economy is a system with a large number of nonlinearly interacting parts, such as, e.g., traders, industrial producers, consumers, and employees. These interactions can lead to positive and negative feedback and emergent effects like self-organization.' (Wand, 2023, 1) As financial entropy increases, the complexity of financial markets is likely to increase. As a result of the unpredictable and unstable nature of the financial system, it may employ more sophisticated financial instruments and strategies to effectively manage risk and generate profits. This may pose obstacles for investors in comprehending and

anticipating the behavior of financial instruments, thereby resulting in heightened risk and uncertainty in financial markets.

*Contagion Risk:* The degree of financial entropy also increases the likelihood of contagion in financial markets. This is due to the fact that emergencies in one sector of the financial system can swiftly spread to other parts, resulting in a cascade of losses and instability. ‘Contagion may become stronger the weaker the integration of risky markets’ (Gârleanu, 2013: 35). The comprehension of the concept of financial entropy facilitates the identification and characterization of the potential for contagion in financial markets, thereby facilitating the development of risk management strategies and policies.

*Market Inefficiency:* The unpredictability and instability caused by financial entropy can lead to market inefficiencies, making it more difficult for investors to identify and capitalize on mispricing or other market inefficiencies. Consequently, it is possible that resources may be allocated in an inefficient manner, resulting in suboptimal market outcomes. ‘Moreover, because arbitrage trading exploits temporary mispricing, it tends to improve the informational efficiency of market prices (assuming the mispricing is genuine).’ (Kirilenko and Lo, 2013: 58).

## 2. Drivers of Financial Entropy

Financial entropy is a multifaceted and complex notion that can be affected by several factors, including economic conditions, market shocks, investor behavior, financial innovation, globalization, regulatory changes. These factors have the capacity to interact in intricate ways, rendering it challenging to accurately predict or regulate financial entropy. Furthermore, the phenomenon of financial entropy is attributed to both internal and external factors, some of which are outlined below:

*Lack of Transparency:* ‘One of the themes that may create an agency problem in financial markets is the transparency of financial institutions. Although transparency of financial institutions is widely discussed by both policymakers and academics, less attention is given to potential influences of transparency on the agency relation between the investors and the fund managers’ (Çitçi, 2014, 269) Transparency in financial markets is crucial. The absence of transparency can result in financial entropy, wherein investors encounter difficulties in comprehending the true worth and performance of financial instruments. This may result in market risk and uncertainty, as investors are unable to make informed investment decisions. It may also result in an improper allocation of resources, as investors may invest in instruments without fully comprehending the risks and rewards involved.

*Behavior of Market Participants:* ‘The behavior of the man in the commercial would have been of no interest to proponents of standard finance. This is not only because his behavior is not in the direct context of finance and not only because his cognitive errors indicate that he is not rational; it is mainly because of the concern that exploration of people’s behavior would distract us from the sole focus on the behavior of markets.’ (Statman, 2019, 166) The behaviors of market participants such as investors, traders and speculators can cause price fluctuations



in financial instruments and increase entropy in financial markets. The interactions among market participants in financial markets can result in chaotic behavior, resulting in markets that are unpredictable and volatile. For instance, if investors develop pessimism regarding the prospects of a particular financial instrument, they may opt to liquidate their investments, resulting in a decline in its value. If investors become optimistic, they may buy the instrument, which will cause its price to rise and increase market entropy. This behavior is commonly referred to as behavioral financing and can result in an increase in market entropy when the price of the instrument departs from the previous equilibrium. Furthermore, the occurrence of investor behavior, such as herding, panic selling, or irrational exuberance, has the potential to cause market instability and volatility, ultimately leading to financial entropy. ‘The term behavioral finance refers to research on financial markets that takes into account the details of human behavior, including human psychology and sociology’ (Shiller, 2005: 10)

*Lack of Information:* Lack of information increases uncertainty, causing financial entropy and making it difficult for investors to make informed decisions. The ramifications of uncertainty in financial markets can be grave, particularly for investors who may encounter difficulties in assessing accurately the worth of financial instruments and securities. This phenomenon has the potential to result in erroneous investment decisions, resulting in markets that are chaotic and challenging to navigate. In order to avert financial entropy, it is crucial for investors to remain informed and abreast of the most recent news and information in order to make informed decisions based on precise information. ‘Investors cannot obtain full information transparency. This argument links the market efficiency problem to the information competition among investors. To be more specific, when the majority of investors hold back in the information competition, gaps of price discovery start to emerge.’ (Lui et al, 2020, 15) Accurate and trustworthy information. Furthermore, financial advisors possess the ability to furnish valuable resources that aid in navigating the intricate details of financial markets and environments. The availability of trustworthy and comprehensive information is crucial in preventing the economic chaos resulting from a lack of information.

*Lack of Transparency:* ‘Lack of information and uncertainty are inherent features of finance, because capital markets are engaged in trade not only in money but also in information itself.’ (Vishwanath and Kaufmann, 2001, 41) Transparency in financial markets is crucial. The absence of transparency can result in financial entropy, wherein investors encounter difficulties in comprehending the true worth and performance of financial instruments. These factors can lead to market risk and uncertainty, as investors are unable to make informed investment decisions. It can also lead to a misallocation of resources, as investors may invest in instruments without fully understanding the risks and rewards involved.

*Economic Factors:* Fluctuations in financial markets can also be linked to macroeconomic factors. These changes have a negative impact on the price of financial instruments, causing an increase in financial entropy. For instance, alterations in interest rates have the potential to impact the value of a currency and



result in its fluctuation. ‘The economic downturn reduces the profitability of many companies and the value of many assets. The stock market declines. Some firms go bankrupt and default on their business loans. Many workers become unemployed and default on their personal loans.’ (Mankiw, 2016: 592).

*Political Factors:* ‘Higher uncertainty and its effects make investors more sensitive to political and economic news. This situation also increases the effect of behavioral tendencies. These results are important in that they show that political and economic developments and explanations affect the current investment decisions by influencing investors' more rational decision making in the context of behavioral finance’ (Pilatin, 2022, 529)

Political events can have a significant impact on financial markets, causing financial entropy to increase. Such occurrences have the potential to alter investor sentiment and impact the availability and demand of financial instruments. For instance, a national election could make investors more cautious or uncertain about the future of the economy, which could lead to more price volatility in financial markets. Similarly, geopolitical tensions between nations result in a reduction in foreign investment and a rise in financial entropy. Furthermore, modifications in governmental policy have the potential to impact the price of financial instruments in a short-term manner, and investors have the ability to react positively or negatively to such modifications.

*Natural Events:* ‘Natural disasters are one cause of disruptions. They usually result in widespread damage to several firms and facilities at the same time. This has a severe impact on an industry and significant time is often required for recovery from natural disasters.’ (Ye and Masato, 2012, 9) Natural events can have a significant impact on financial markets, causing an increase in entropy. This phenomenon may be attributable to abrupt fluctuations in the demand for goods and services, as well as disruptions in the supply chain. Natural occurrences have the potential to cause financial entropy by affecting supply chains, resulting in diminished market liquidity, elevated transaction costs, and inefficiencies in pricing and valuation.

*Risk Factors:* Financial instruments are subject to various risk factors, which can affect their prices and lead to financial entropy. These risks have the potential to generate uncertainty and instability in financial markets, thereby leading to inefficiencies and an elevated risk for investors and other market participants.

*Market Structure:* ‘In the context of applications of networks to financial markets and institutions, a very useful approach has proven to be the use of entropy-based measures. Several studies have focused on the use of entropy as a variable that can reveal the state of the market or a tool that can be used to explore the relationship between different stocks.’ (Caraiani, 2018, 1) The structure of financial markets affects the price of financial instruments and creates more entropy. Market structures have the potential to generate financial entropy in numerous ways, one of which is the concentration of market power. If a few significant corporations hold a dominant position in the market, they possess the ability to manipulate prices and engage in anti-competitive conduct, resulting in a heightened level of market entropy.

*Globalization:* ‘Financial globalization is an aggregate concept that refers to increasing global linkages created through cross-border financial flows. Financial integration refers to an individual country's linkages to international capital markets. Clearly, these concepts are closely related. For instance, increasing financial globalization is perforce associated with increasing financial integration on average.’ (Prasad et al, 2003, 7) The entanglement of global financial markets can lead to chain reactions, where problems in one market or country can quickly spread to other markets, leading to an overall increase in financial entropy. A financial crisis in one market can prompt investors to withdraw from other markets, resulting in a swiftly spreading effect. The effective management of financial entropy at the global level necessitates coordinated efforts by nations and institutions, as well as effective risk management strategies at the individual market and firm levels.

*Regulatory Changes:* ‘Regulators responded to the crisis with more capital, standardization in liquidity, stronger supervision, and more specific solutions. Along with the changes in the globalization tendency of the real economy, due to the weak economic growth and low interest rates in most developed economies, the working area of the banks has changed significantly.’ (Şengül, 2020, 320) Changes in the rules of financial markets can significantly affect market participants, create uncertainty and unpredictability, and thus increase financial entropy. Any modifications in fiscal policy, monetary policy, or financial reporting requirements may alter the conduct of market participants, thereby resulting in modifications in market conditions and overall market stability. Furthermore, regulatory changes can have unintended consequences. Hence, it is critical for policymakers and regulators to thoroughly scrutinize the potential ramifications of regulatory modifications and exert efforts to mitigate uncertainty and unpredictability in the financial markets. Communication and transparency also help reduce uncertainty and promote market stability.

*Market Shocks:* ‘In our globally interconnected economies, shocks within a part of the economic system – or originating from outside -- can turn into severe global economic downturns through cascading failures across the whole system, contributing to growing inequalities, polarization of society as well as trust erosion and the spreading of disinformation’ (Pinaud and Boone, 2021, 11) Unexpected events or market shocks can have a significant impact on financial markets, disrupting normal market operations and creating uncertainty and chaos. For instance, a natural catastrophe has the potential to disrupt a supply chain, resulting in a decrease in the cost of affected tools or commodities, while the cost of replacement may escalate. Furthermore, political instability may result in a loss of faith in the national currency or financial markets, resulting in the withdrawal of investors from the market and a significant decline in the prices of instruments. Furthermore, the unanticipated demise of a substantial corporation or financial institution may result in a loss of faith in the financial system, resulting in a flurry of foreclosures and a broader market disruption.

*Financial Innovation:* ‘Technological developments have long played a critical role in the advancements in finance. In recent years, the spread of information

technologies in the banking and finance sector has led to the rapid development of digital technologies' (Yüzbaşıoğlu, 2023, 550) Financial entropy can increase with the introduction of new financial instruments or innovations that may introduce new risks and uncertainties that were not present before. For instance, the emergence of novel digital currencies or payment systems has the potential to generate cybersecurity, privacy, and fraud hazards, thereby escalating uncertainty and diminishing trust in financial markets. Furthermore, the utilization of sophisticated algorithms and machine learning in the realm of trading and investing may potentially introduce novel hazards associated with market manipulation and 'flash crashes', which may result in abrupt and severe market disruptions.

### 3. Theories for Measuring Financial Entropy

Effectively managing financial entropy is a multifaceted endeavor that requires multiple approaches and strategies. Techniques such as diversification, risk management, portfolio optimization, hedging, market timing, and behavioral analysis are integral to effectively managing financial entropy. The key is to devise a comprehensive strategy that encompasses the distinctive characteristics of the particular financial market, as well as the individual investor's individualized objectives and risk tolerance. It is critical to consistently monitor the financial market conditions and adjust strategies accordingly. The concept of financial entropy can be explicated through a variety of methodologies, including random walks, noise in financial markets, entropy measures, and entropy-based risk measures.

A random walk refers to the unpredictable and random way in which a financial product changes over time. 'The theory of random walk says that future path of the price level of a security is no more predictable than the path of a series of cumulated random numbers.' (Fama, 1965: 34) Financial entropy can be considered as a measure of disorder in the financial system, and the unpredictability of changes in the prices of financial instruments can be considered as a form of this disorder. The sampling walk theory can provide an estimation of financial entropy by examining the autocorrelation of returns on financial instruments. Autocorrelation is a statistical technique that measures the correlation between the returns of a financial instrument over various time intervals. A high correlation indicates predictable price movements, while a low correlation indicates a random walk. Hence, the greater the degree of dearth of correlation, the greater the degree of financial entropy.

In financial markets, noise refers to the unpredictable and irregular price movements of financial instruments caused by various factors such as economic conditions, market sentiment and news events. The term 'noise' is employed to denote the degree of randomness or uncertainty present in financial markets. To utilize noise to assess financial entropy, it is crucial to calculate the standard deviation of the return of a financial instrument. This is a statistical measure utilized to quantify the degree of volatility or uncertainty in the returns of a financial instrument.

Other measures of financial entropy include entropy indices, entropy scores, and risk-based measures. These measures employ data to quantify the degree of disorder or randomness present in financial markets. ‘Three different non-parametric estimation procedures are considered to evaluate financial entropy, namely kernel density estimated Shannon entropy, kernel density estimated Renyi entropy.’ (Deeva, 2017: 1889) The most widely used measure of financial entropy is the Shannon entropy. It evaluates the degree of randomness or unpredictability of a system by examining its probability distribution. The Tsallis entropy is a more adaptable variant of the Shannon entropy, and it is capable of accommodating non-extensive systems.

Shannon defined entropy as the amount of uncertainty or randomness in a system based on a probability distribution rather than the cost or value of information processing. However, his work in information theory was used to examine the costs and values of information processing. ‘The Shannon entropy is applied in order to measure the quantity of information contained in the series.’ (Risso, 2008: 398) As a result, Shannon’s theory has been applied to a wide diversity of fields. ‘Since information is the reduction of entropy and all human activities are crucially entropy processes, it is natural to comprehend human psychology and market patterns from the viewpoint of entropy theory.’ (Chen, 2003: 26). The degree of uncertainty or randomness in a probability distribution can be measured using this formula. This formula is usually applied to the distribution of revenue from financial instruments.

Shannon refers to  $H$  as the entropy of the set of probabilities, as follows: (Shannon, 1948: 390)

$$H = -K \sum_{i=1}^n p_i \log p_i \tag{4}$$

To calculate financial entropy using Shannon entropy, estimate the probability distribution of the price return of the financial instrument and then calculate the financial entropy value using the above formula. ‘The entropy may be sensibly applied to financial time series. The decisive advantage of this approach resides in its ability to account for nonlinear dependencies’ (Darbellay and Wuertz, 2000 p. 438) Tsallis entropy is a generalization of the standard Shannon entropy formula used to measure financial entropy. The Tsallis entropy formula introduces a novel parameter,  $q$ , which enables the inclusion of long-range correlation and non-extension in the calculation of financial entropy.

The Tsallis entropy is calculated as follows: (Tsallis, 1988)

$$S_q = \frac{k}{q-1} \sum_{i=1}^w p_i (1 - p_i^{q-1}) \tag{5}$$

Tsallis entropy can measure financial entropy by adjusting the value of the  $q$  parameter and can capture different types of market behavior. The probability of

$p_i$  denotes the probability of varying outcomes in financial markets. Alfred Rényi proposed Rényi entropy in 1961, which is a general form of Shannon entropy and can be utilized to measure financial entropy.

$$H_\alpha(p) = \frac{1}{1-\alpha} \log_2 \left( \sum_{k=1}^n p_k^\alpha \right) \quad (6)$$

The Rényi entropy is a generalization of the Shannon entropy and has been used in finance to measure various aspects such as the risk of financial portfolios, the diversity of financial marketplaces, and the complexity of financial time series. In order to assess the risk of a portfolio, Rényi entropy considers an extreme event or a small risk, whereas to assess market diversity, it considers the concentration of financial market value. The first advantage of employing Rényi entropy is its ability to calculate the entropy for various values of  $\alpha$ , thereby enabling a more comprehensive comprehension of the randomness or uncertainty of financial data. ‘In compliance with efficient market hypothesis, the stock market is an equilibrium system, which is a requirement for the implementation of Shannon and Rényi entropies.’ (Deeva, 2017: 1890)

‘Compared to Shannon entropy, Rényi entropy features a parameter that can be tuned to play around the notion of uncertainty.’ (Lassance and Vrins, 2021: 1). There are several ways to measure financial entropy, but there is no consensus on which method to use, making it difficult to compare research results and practical applications. The computation of financial entropy can prove to be challenging due to its computational complexity and intensity, as well as the requirement for substantial amounts of data and specialized software. Moreover, the presumption of data normality may impair the precision and relevance of financial entropy measures. The absence of historical data and the non-stationarity of financial markets further restrict the practical application of financial entropy. Despite these limitations, financial entropy has potential as a tool for financial risk management and portfolio optimization.

#### 4. Quantum Analogy for Financial Entropy

Econophysics is a notion that integrates the dynamics of economics and physics to comprehend macroeconomic phenomena. This multidisciplinary approach employs concepts and techniques from physics to analyze intricate economic systems and predict their dynamics and behavior. Economic physics uses a variety of methods, such as statistical mechanics, thermodynamics, and chaos theory, to study economic problems. Industry experts develop mathematical models to explicate market and economic behavior and employ computational techniques to evaluate the outcomes of diverse economic policies. ‘The Researches of Econophysics deal with the distributions of returns in financial markets, the time correlation of a financial series, the analogies and differences between price dynamics in a financial market and physical processes as turbulence or ecological systems, the distribution of economic stocks and growth rate variations, the distribution of firm sizes and growth rates, the distribution of city sizes, the

distribution of scientific discoveries, the presence of a higher-order correlation in price changes motivated by the reconsideration of some beliefs, the distribution of income and wealth, the studies of the income distribution of firm and studies of the statistical properties of their growth rates'. (Săvoiu and Iorga-Simăn, 2008: 31)

This study offers a comparison between quantum mechanics and financial entropy, the so-called 'financial entropy quantum analogy'. The notion is founded on the notion that financial markets are intrinsically uncertain and unpredictable, akin to the behavior of quantum particles. In the field of quantum mechanics, entropy is a quantitative indicator of the degree of unpredictability in a system. It is related to the Heisenberg Uncertainty Principle, which asserts which the precise position and momentum of a quantum particle not determined simultaneously. (Heisenberg, 1927).

$$\Delta x \Delta p \geq \frac{h}{4\pi} \quad (7)$$

where  $\Delta x$  is the position uncertainty and  $\Delta p$  is the momentum uncertainty.

The Heisenberg Uncertainty Principle is a basic principle of quantum that states that the properties of an individual particle, such as its position and velocity, cannot be known simultaneously with high precision. This principle has been utilized to explicate the behavior of subatomic particles, and it has also been employed in other domains, such as finance, to delineate the uncertainty and unpredictability of financial markets. The application of this principle to finance demonstrates that, akin to the uncertainty principle in physics, it is unfeasible to precisely identify certain characteristics of financial markets. The range of possible exchange rates can be regarded as a 'wave function' of money in quantum mechanics, and the real value of the exchange rate prior to the transaction is uncertain, akin to the distribution of the wave function in quantum mechanics.

The first quantum notion of financial entropy is the principle of superposition. 'Superposition is the ability of a quantum system to be in multiple states at the same time.' (Jayaram and Adavi, 2021: 18) Superposition is the ability of a quantum system to exist in multiple states simultaneously. 'Quantum decision models assume that evidence develops over time in a superposition state analogous to a wavelike pattern and that judgments and decisions are constructed by a measurement process that creates a definite state of evidence is created from this indefinite state' (Kvam et al., 2015: 10645) Superposition in finance can also mean that multiple market conditions are happening at the same time, such as a rising stock market and a falling bond market, which can create uncertainty for investors about the market's future direction.

The notion of superposition of states in quantum mechanics can be applied to financial instruments to represent their possible range of prices. The purchase and sale of financial instruments can occur simultaneously in multiple states, similar to the phenomenon of quantum particles exhibiting multiple states simultaneously. This phenomenon can be regarded as a manifestation of financial entropy. For instance, the stock price overlay shows that the value of a stock can exist in several states at the same time depending on the influence of various

internal and external factors. ‘The stock markets reflect the interaction of many agents buying or selling a particular index. Influenced by their beliefs and the economic situation, the agents may feel inclined to buy or sell under markets with clear trends or act more erratically in epochs of great uncertainty. Therefore, by quantifying the degree of randomness of the stock markets we can obtain insights on the general behavior of the participants.’ (Delgado-Bonal, 2019, pp 1) Similar to financial overlays, the value of a stock can have multiple possible prices due to the predictions of buyers and sellers in the financial market and the influence of external factors. ‘Treats a judgment or decision as a measurement process that constructs a definite state from an indefinite (superposition) state’ (Kvam et al., 2015: 10650)

The second quantum notion of financial entropy is the principle of entanglement. ‘Entanglement is the strong correlation between quantum particles.’ (Jayaram and Adavi, 2021: 18) ‘Quantum decision theory and in particular entanglement between objective calculations and subjective emotions, therefore, helps to explain why so few people in similar situations really chose to default during the crisis, even if their behavior seems to defy both classical utility theory and the results of surveys: when it came to the crunch, entangled emotions such as guilt and fear interfered with and outweighed abstract considerations of utility’ (Orrell, 2022: 12) In the finance world, entanglement occurs when two or more financial instruments are interconnected in such a way that the movement of one instrument affects the movement of another. This is due to the interconnected nature of the instruments, and the movement of one instrument can have an impact on the movement of another.

Entanglement can increase uncertainty and risk in financial markets, as movements in one instrument can affect movements in another instrument. For instance, if the price of a stock rises, the value of a call option on that stock will also rise. Nonetheless, if another trader holds a put option on the identical stock, which grants the right to offer the stock at a certain price, the value of the put option will decrease in proportion to the increase in the stock price. In this particular instance, it can be observed that the correlation between the value of call and put options is positive, indicating that as the value of one option goes up, the value of the other option decreases. This results in a mutual dependence between the two alternatives, wherein the value of each option is contingent upon the value of the other option.

Financial entanglement refers to the connection between different financial instruments, where changes in one financial instrument will affect changes in another financial instrument, thereby creating increased risks and instability in the financial market. This phenomenon can also be utilized to analyze the possibility of contagion, wherein financial instability spreads from one market to another. Understanding the degree of financial mixing in diverse markets can assist market participants in assessing the likelihood of contagion and implementing appropriate risk management measures. Financial contagion occurs when uncertainty in one market adversely impacts another market, resulting in increased volatility and a detrimental effect on the overall health of the global financial system. ‘The market



is subject to contagion, in that an adverse shock to investors at a subset of locations affects prices everywhere.’ (Gârleanu et al., 2013: 1)

A common instance of financial contagion is banking crisis contagion, which occurs when a crisis in one country spreads rapidly to other countries due to the complexity of the global banking system. This entanglement may be attributed to cross-border lending, wherein banks in one nation possess significant influence over banks in other nations. Hence, a financial crisis in one nation may potentially result in financial crises in other nations. Another method of economic diffusion is trade links. A crisis in one nation has the potential to reduce the demand for goods and services from that country, thereby reducing the demand for goods and services in other countries that have trade relations with the affected nation. This could potentially result in a decline in economic activity in other nations, ultimately leading to a financial crisis.

Exchange rates and interest rates are intricately linked to commodity prices. If exchange rates change, it will affect the competitiveness of various goods in the world market, thereby causing changes in their prices. Furthermore, alterations in interest rates will have an impact on the demand for raw materials, resulting in alterations in their prices. Furthermore, financial contagion can spread when demand for certain goods shifts from one region or country to another. For instance, if China’s demand for a particular commodity changes, it will have an impact on the global price of that commodity.

The third quantum notion of financial entropy is the principle of interference. ‘As seen in quantum cognition, the fact that contradictory potential states are held in superposition leads to interference effects, which alter the probability distribution at each time step.’ (Orrell, 2021: 67) Financial interference is a term used to describe how the behaviors of one market participant affect another market participant, causing unpredictable outcomes in financial markets. This concept is akin to that of interference in quantum mechanics, wherein waves interact to generate patterns of constructive and destructive interference. Derivative interference is a financial impairment that arises when the value of one derivative contract is affected by the existence or value of another derivative contract, owing to the correlation between the underlying instruments or market conditions. The concept of interference highlights the unpredictable and random nature of financial markets, where the value of one financial instrument can have an impact on the value of another financial instrument, even if they are not related.

Constructive interference, also known as anti-resonance, occurs when two or more derivatives combine and increase each other’s value or amplitude, resulting in an overall gain. This can be compared to a stock with a positive beta that moves in the same direction as other stocks. Beta is a parameter of the risk or volatility of an investment in relation to the market as a whole. It is calculated by dividing the covariance of the investment return with the market return by the change in the market return. ‘In the world of finance, the term ‘beta’ refers to the slope in a linear relationship fitted to data on the rate of return on an investment and the rate of return of the market.’ (Tofallis, 2008: 2)

Anti-resonance is a term of finance to describe the phenomenon where financial marketplaces have little response to external stimuli close to their natural frequencies. This phenomenon arises when the market absorbs or dissipates the impact of the stimulus, resulting in a decrease in the market resonance. An anti-resonance can be regarded as an opposing market force or trend that opposes the dominant market trend or consensus, resulting in a decrease in market amplitude or intensity. For instance, during a bull market, countertrends may arise, which temporarily disrupt the dominant trend and diminish market reaction.

Furthermore, during a bear market, an amplification factor, such as favorable news or economic data, may arise, causing a temporary disruption of the established trend and resulting in a subdued market response. Nonetheless, these countervailing market forces or anti-resonance are prone to uncertainty and may be triggered by a variety of factors, including alterations in economic conditions, geopolitical developments, or unanticipated modifications in investor sentiment. Therefore, investors should remain vigilant and maintain a diversified portfolio in order to respond to unexpected changes in market conditions.

Destructive interference is a term in wave theory that occurs when two waves or signals are combined in a way that reduces their amplitude or value. In the realm of financial markets, the term can be used to denote a scenario where two opposing forces in the market counterbalance each other, resulting in a reduction in market uncertainty. Disturbance, also known as negative beta, arises when two market forces with opposing effects are present in a market simultaneously, resulting in a reduction in market uncertainty. For instance, if a company or industry receives both favorable and unfavorable news, the volatility of the market may decrease as the two opposing forces cancel each other out.

Resonance is a financial term that refers to how market participants are more influenced by certain trends or news events that match their existing beliefs or biases. This phenomenon causes people to be more sensitive to certain types of information, which increases the likelihood of herd behavior and greater impact on market prices. Market participants may be inclined to pay greater attention to news and events pertaining to specific industries, resulting in a greater impact on market prices and a greater tendency towards herding behavior. Nonetheless, it is crucial to acknowledge that resonance also contributes to the occurrence of market booms and crashes, as market participants are more susceptible to irrational exuberance and panic. Hence, it is necessary for investors to maintain vigilance, maintain a balanced and diversified investment portfolio, and refrain from excessive exposure to a singular trend or market signal.

While the comparison between quantum mechanics and financial entropy can provide interesting theoretical insights, it is crucial to approach such comparisons with caution and recognize the inherent differences between these domains. Overly simplistic analogies or misinterpretations could lead to erroneous conclusions about the nature of financial markets. Here are some limitations of quantum analogy:

*Complexity of Financial Systems:* "The complex systems perspective shows that financial markets exhibit a dynamical complexity that is neither due to the

complexities of human behavior nor to uncontrollable external influences' (Kuhlmann, 2014, 15) Financial markets involve interactions among numerous variables and agents, making them vastly more complex than the systems typically studied in quantum mechanics. While quantum systems can be highly complex, financial systems often exhibit even greater levels of unpredictability and non-linearity due to the involvement of human behavior, institutional dynamics, and regulatory frameworks.

*Quantum Mechanics vs. Classical Mechanics:* Quantum mechanics operates at the level of very small particles, while classical mechanics describes the behavior of macroscopic objects. Financial entropy, on the other hand, pertains to large-scale systems involving markets, institutions, and economic actors. Directly applying concepts from quantum mechanics to financial systems may oversimplify the dynamics at play.

*Interpretational Challenges:* Quantum mechanics has various interpretations, each with its own philosophical implications. Applying these interpretations to financial systems can lead to conceptual challenges and ambiguity. Quantum uncertainty might have a clear physical interpretation, financial markets might not a clear interpretation. 'Quantum mechanics involves precise mathematical language and structure (the formalisms), but there is no consensus (a) on whether or not quantum mechanics must also involve interpretation; nor (b) on whether or not any such interpretation should lead to understanding.' (Drummond, 2019, 391)

*Quantum Effects vs. Market Rationality:* 'Quantum finance uses the tools of quantum mechanics to model financial markets, covering probability, state evolution, uncertainty, and asset correlations with techniques like wave functions, Schrödinger's equation, and entanglement, offering insights into market behavior'(Zheng and Bai, 2024, 3) Financial markets are often assumed to be driven by rational behavior and efficient pricing mechanisms, which may not align with the inherent randomness and unpredictability of quantum systems.

*Empirical Validation:* While theoretical parallels between quantum mechanics and financial entropy can be drawn, empirical validation of such comparisons may be challenging. Financial data often exhibit non-stationarity, noise, and other confounding factors that make it difficult to directly test hypotheses derived from quantum-inspired models. 'Various research studies have been utilizing models and techniques to apply the laws of a quantum system to the macro world's social systems and financial markets. Moreover, one of the most distinctive features of financial market data lies in their non-Gaussian performance and the occurrence of the probability of extreme events' (Hosseini et al., 2023, 7)

*Limited Applicability:* While insights from quantum mechanics may inspire novel approaches to understanding financial systems, it is essential to recognize that not all aspects of financial markets can be accurately captured using quantum analogies. 'But in quantum, even though there are straightforward rules to apply bits and information to the quantum world there is no analogy and that starts really at the core.' (Meghji, 2021, 2)

## 5. Principles of Financial Entropy

Financial markets are platforms or markets where market participants exchange various financial instruments such as stocks, bonds, currencies, commodities, and derivatives. The aforementioned term encompasses a variety of financial instruments that are traded and purchased by individuals, organizations, and corporations. It is a mechanism that facilitates the flux of funds between investors and borrowers. The financial markets provide businesses and governments with a cost-effective means of raising funds through the sale of securities to investors. Investors can use financial markets to diversify their portfolios, manage risk, and purchase and sell financial instruments. The pricing of financial instruments in the market is influenced by the forces of supply and demand and is influenced by the perceptions and expectations of the market participants.

The financial market can be compared to an atom consisting of different particles. 'In this model, the essential elements of the financial market are the 'market atoms' the securities are the core of the value, analogous to the nucleus of an atom' (Zheng and Bai, 2024, 5) Similarly, financial markets include various financial instruments, such as stocks, bonds, currencies, commodities, and derivative. The price in the process of movement also make a jump from one track to another track movement. The valuation of these instruments is susceptible to a variety of factors, including economic conditions, political events, company performance, and investor sentiment. As particles in an atom can transition between diverse energy levels, financial instruments in financial markets can experience fluctuations in value as they transition between diverse bid and offer levels. For instance, in case of a high demand for a stock, its price will rise, whereas in case of a low demand, its price will decrease. The value of financial instruments is the basis for transactions in financial markets, and investors are able to buy and sell these instruments for a profit.

*Financial markets are unpredictable:* The fragility of this system makes it more crisis-prone and ultimately more volatile and unpredictable' (Lockwood, 2015, 24) Financial markets are characterized by their inherent unpredictability, as it is impossible to accurately anticipate the future performance of financial instruments. This unpredictability is attributed to a multitude of factors that impact financial markets, including economic conditions, political events, company performance, and investor sentiment, which are often challenging to accurately predict.

*Financial markets are dynamic and constantly evolving:* 'The stock market is a real and continuously evolving extremely complex dynamic system' (Yang and Hou, 2022, 1) Financial markets are constantly evolving, and the value of financial instruments can change significantly over time. The regulations governing financial markets may also undergo modifications, resulting in modifications in the valuation of financial instruments. Furthermore, technological advancements have impacted the financial markets, as digital trading platforms and algorithmic trading tools facilitate transactions with greater speed and efficacy, thereby altering the manner in which financial markets operate.

*Financial markets are interconnected:* ‘The global financial system is highly complex, with cross-border interconnections and interdependencies. In this highly interconnected environment, local financial shocks and events can be easily amplified and turned into global events.’ (Raddant and Kenett, 2021, 2) The value of one financial instrument can be affected by the value of another financial instrument, even if they are not correlated. This interdependence has the potential to cause financial contagion, wherein a shock or disruption in one market can spread to other markets and trigger a chain reaction. For instance, a calamity in the housing market may result in a decline in the value of mortgage-backed securities, thereby affecting the valuation of other financial instruments such as bonds and stocks.

*Financial market is influenced by human behavior:* The conduct of market participants has the potential to significantly impact the financial market. This concept is referred to as behavioral finance. According to the theory, people’s emotions, biases, and cognitive errors can influence financial decisions and lead to irrational behavior in financial markets. For instance, during a bull market, investors may exhibit excessive optimism and invest excessively in a particular instrument, resulting in the formation of a price bubble that ultimately bursts. ‘The evidence of behavioral persuasions suggests that individual investors need to control their behavioral emotions in making investment decisions. Identifying the relative importance of biases in influencing a decision may help them gain a better understanding of behavioral psychology, which will help investors develop a better investment strategy.’ (Hossain and Siddiqua, 2022, 12)

‘Quantum finance provides a comprehensive framework that can, in principle, price and hedge any financial instrument. Quantum finance extends the formalism of quantum mathematics to a new domain; in particular, financial instruments are represented by state vectors that are not normalizable’ (Baaquie, 2013, 1673) Using the principles of quantum mechanics, financial instruments can be compared to particles subject to various forces. These forces can affect the movement of financial instruments in different directions and at different speeds, as particles in the physical world are affected by different forces. Financial markets comprise a diverse array of financial instruments, and the principles of financial entropy are applicable to all of the financial instrument’s present in the market. These factors may result in a fluctuation in the value of the financial instrument over time, and it is highly unlikely that its value will sustain an upward trend. Furthermore, it is noteworthy that financial markets frequently undergo growth cycles, which implies that even if a financial instrument experiences an increase in value, it may eventually reach its peak and commence a decline. Furthermore, a significant number of financial instruments are subject to periodic market corrections and adjustments, which may result in a decrease in their value.

Financial markets are constantly changing and dynamic and consist of various markets in which financial instruments such as stocks, bonds and currencies are traded. These markets are subject to cycles of growth and expansion, followed by periods of contraction and decline. For instance, the stock market undergoes both bull and bear market cycles, and bull markets are characterized by

a rise in stock prices, a substantial trading volume, and a surge in investor optimism. In contrast, a bear market is characterized by a decline in stock prices, a reduction in trading volumes, and a rise in investor pessimism.

Despite their importance, financial markets are susceptible to various challenges and vulnerabilities. These may include market volatility, systemic risks, regulatory issues, and the impact of global events such as economic crises or geopolitical tensions. Understanding and addressing these challenges is essential for maintaining market stability and safeguarding investor interests' (Samuels, 2024, 1) Financial market conditions are a complex and multifaceted notion that can be viewed from different perspectives and interpretations. The financial markets comprise a diverse array of players, each possessing distinct objectives, motivations, and tactics, including investors, traders, speculators, and governments.

Depending on the participants perspective and interpretation of market conditions, their behavior and decisions may be influenced. For instance, a financial market may exhibit an upward trend from a technical analysis standpoint, whereas it may exhibit a downward trend from a fundamental analysis standpoint. Moreover, the financial markets can experience a bull market, wherein values rise, and investors are optimistic, or a bear market, where values decline, and investors are pessimistic. This statement articulates several significant points regarding the nature of financial instruments, including: (a) the value of a financial instrument is not permanent, (b) it fluctuates indefinitely, (c) it fluctuates indefinitely, and (d) it can possess multiple values simultaneously.

### **Conclusion**

Entropy is a key notion in thermodynamics and statistical mechanics that measures the degree of disorder and randomness in a system. The capacity of a system is a characteristic that determines the amount of energy that cannot be utilized for productive purposes. In a closed system, the rate of entropy increases with time, indicating that the system is becoming increasingly disordered and incapable of performing productive activities.

Financial entropy refers to the disorder or unpredictability present in financial markets, which has a significant impact on the stability and efficacy of the economy. In the realm of finance, entropy is a quantitative indicator of the randomness and uncertainty inherent in financial variables, such as instrument prices and returns. A high level of financial entropy can increase market volatility and make it difficult for investors to make informed decisions. Both internal and external factors play a significant role in the phenomenon of financial entropy. Financial institutions and regulatory authorities are taking measures to mitigate entropy by implementing risk management strategies, enhancing transparency and disclosure requirements, and fostering market stability. A comprehensive comprehension of financial entropy and its implications is required for financial professionals, policymakers, and investors.

Recently, quantum mechanics has been proposed as a novel methodology for comprehending financial entropy, thereby providing a distinct perspective on the behavior of financial markets. The utilization of analogies between the



probabilistic behavior of quantum systems and the randomness of financial variables provides novel insights into the nature of financial entropy. In this methodology, financial variables such as instrument prices, returns, and market performance are regarded as quantum states whose probabilistic behavior is governed by the principles of quantum mechanics. Concepts such as superposition, entanglement, and interference delineate the interrelationships among diverse financial variables and their interdependence. Financial instruments are compared to particles that are subjected to varying forces, resulting in their movement in shifting directions and speeds, akin to the physical world. Nonetheless, the value of financial instruments is not invariably stable, as it fluctuates and can fluctuate in multiple values at any given moment.

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