Overview of the Course

Behavioral finance is often presented as a challenge to rational decision making and market efficiency. Borrowing from the literature on market efficiency, we can group departures from rational behavior into three familiar categories (weak, semi-strong, and strong). In the weak-form, psychological biases affect investing behavior and can influence welfare but have no lasting impact on asset prices. In the semi-strong form, behavioral biases also have an effect on corporate managers but any suboptimal behavior is recognized by the market and incorporated into security prices. Finally, in the strong form behavioral biases are so pervasive that they can lead asset prices to depart nontrivially from fundamental values.

This half-semester course is designed to provide students with exposure to behavioral finance. We’ll begin with an overview of behavioral biases documented in the cognitive psychology literature and then discuss their implications for finance.

Readings

Many of the books on behavioral finance are collections of journal articles. We’ll focus on the articles themselves, with references to some of the helpful literature surveys.

Grading

Each student is expected to make three 20 minute presentations. Grading is based on the presentations and class participation.

Office Hours

You can stop by any time. If you want to make sure that I’m free, send me an email first.
The Daily Schedule

The schedule below is intended as a guide. It may be modified depending on the speed and comfort level of the class.

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<th>Topic</th>
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<td>Overview of Behavioral Biases</td>
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<td>2</td>
<td>9/12</td>
<td>Overview of Behavioral Biases (continued)</td>
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<td>3</td>
<td>9/19</td>
<td>Investor Behavior – Portfolio Construction and Home Bias</td>
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<td>Investor Behavior – Trading</td>
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<td>10/3</td>
<td>Investor Behavior – Attention and Weather</td>
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<td></td>
<td>10/10</td>
<td>Fall Break</td>
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<td>6</td>
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<td>Time Discounting</td>
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<td>7</td>
<td>10/24</td>
<td>Limits to Arbitrage – Theory</td>
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<td>10/31</td>
<td>Limits to Arbitrage – Empirical</td>
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<td>9</td>
<td>11/7</td>
<td>Behavioral Models – Prospect Theory</td>
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<td>10</td>
<td>11/14</td>
<td>Behavioral Models – Overconfidence</td>
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<td>Tests of Behavioral Models – Prospect Theory</td>
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<td>11/28</td>
<td>Tests of Behavioral Models – Sentiment</td>
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<tr>
<td>13</td>
<td>12/5</td>
<td>Tests of Behavioral Models – Misreaction</td>
<td>(28, 29, 30)</td>
</tr>
<tr>
<td>14</td>
<td>12/12</td>
<td>Tests of Behavioral Models – Attention</td>
<td>(31, 32)</td>
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Readings

Overview

Surveys

Commentaries

Investor Behavior

Portfolio Construction


**Home Bias**


**Trading**


Attention


Weather


Time Discounting


Limits of Arbitrage – Theory


Limits of Arbitrage – Empirical

Behavioral Models

Prospect Theory


Sentiment


Overconfidence


Other


Tests of Behavioral Models

Prospect Theory

Sentiment


Misreaction


Attention