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

Grading is based on a combination of in class presentations and referee reports.

Office Hours

You can stop by any time. If you want to make sure that I’m free, send me an email first.
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<td>12/11*</td>
<td>Tests of Behavioral Models</td>
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*Tuesday instead of Thursday
Overview

Surveys

Commentaries
Investor Behavior

Portfolio Contraction


Home Bias

• Ivkovic, Zoran, and Scott Weisbenner, 2005, “Local does local is: information content of the geography of individual investors’ common stock investments,” *Journal of Finance*.

Trading

• Barber, Brad M., and Terrance Odean, 2000, Trading is hazardous to your wealth: The common stock investment performance of individual investors,” *Journal of Finance*.


• Odean, Terrance, 1998, Are investors reluctant to realize their losses? *Journal of Finance*.
• Odean, Terrance, 1998, “Volume, volatility, price, and profit when all traders are above average,” *Journal of Finance*. 


**Attention**


**Weather / Mood**

• Hirshleifer, David and Tyler Shumway, 2003, “Good day sunshine: stock returns and the weather,” *Journal of Finance*.


**Corporate Finance – Manager Behavior**

Manager Response to Investor Biases


Manager Bias


**Limits of Arbitrage – Theory**


**Limits of Arbitrage – Empirical**


**Behavioral Models**

**Prospect Theory**
• Barberis, Nicholas, Ming Huang, and Tano Santos, 2001, “Prospect theory and asset prices,” *Quarterly Journal of Economics*.

**Sentiment**

**Overconfidence**

Other

**Tests of Behavioral Models**

Prospect Theory
• Grinblatt, Mark, and Bing Han, 2005, “Prospect Theory, Mental Accounting, and Momentum, *Journal of Financial Economics*.

**Sentiment**


**Comovement**


**Misreaction**
• Tetlock, Paul, 2011, “All the news that’s fit to reprint: Do investors react to stale information?” *Review of Financial Studies*.

**Attention**

Lotteries
• Han, Bing, and Alok Kumar, 2010, “Speculative Retail Trading and Asset Prices,” Working Paper, University of Texas.