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. Two books I recommend are *Thinking Fast and Slow* by Daniel Kahneman and *The Myth of the Rational Market* by Justin Fox.

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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Readings

Overview

Surveys

• DellaVigna, Stefano, 2009, Psychology and economics: Evidence from the field, *Journal of Economic Literature*.

Commentaries

• Thaler, Richard H., 2000, From homo economicus to homo sapiens *Journal of Economic Perspectives*. 
Investor Behavior

Portfolio Construction

- Gianetti, Mariassunta, and Tracy Yue Wang, 2015, Corporate scandals and household stock market participation, *Journal of Finance.*

Home Bias

• Doskeland, Trond, and Hans K. Hvide, 2011, Do individual investors have asymmetric information based on work experience? *Journal of Finance*.
• 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*.
- Barber, B., and T. Odean (2001), Boys will be boys: gender, overconfidence, and common stock investment, *Quarterly Journal of Economics*.


- Heimler, Rawley, 2016, Peer pressure: Social interaction and the disposition effect, *RFS*.
• 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*.
• Shefrin, H., and M. Statman (1985), The disposition to sell winners too early and ride losers too long, *Journal of Finance*.

Attention

• DellaVigna, Stefano, and Joshua Pollet, 2009, Investor inattention, firm reaction, and Friday earnings announcements, *Journal of Finance*.
• Gurun, Umit, and Alexander Butler, 2012, Don’t believe the hype: Local media slant, local, advertising, and firm value, *Journal of Finance*.

Weather / Mood
• Chen, Jing, Elizabeth Demers, and Baruch Lev, 2013, Oh what a beautiful morning! The time of day effect on the tone and market impact of conference calls, Working Paper, NYU.


**Corporate Finance – Manager Behavior**

Manager Response to Investor Biases


Dong, Ming, David Hirshleifer, and Siew Hong Teoh, 2012, Overvalued equity and financing decisions, Review of Financial Studies.


Manager Bias
• Benmelech, Efraim, and Carola Frydman, 2015, Military CEOs *Journal of Financial Economics*.
• Bernile, Gennaro, Vineet Bhagwat, and P. Raghavendra Rau, 2016, What doesn’t kill you will only make you more risk-loving: Early-life disasters and CEO behavior. *Journal of Finance*.
• Chung, Kiseo, T. Clifton Green, and Breno Schmidt, 2016, CEO home bias and corporate acquisitions, Working Paper, Emory.
• Dittman, Ingolf, Ernst Maug, and Oliver Spalt, 2010, Sticks or carrots? Optimal CEO compensation when managers are loss averse, *Journal of Finance*.

• Green, T. Clifton, Russell Jame, and Brandon Lock, 2016, It pays to be extraverted: executive personality and career outcomes, Working Paper, Emory.
• Hirshleifer, David, Angie Low, and Siew Hong Teoh, 2012, Are overconfident CEOs better innovators? *Journal of Finance*.

- Malmendier, Ulrike, and Geoffrey Tate, 2005, CEO overconfidence and corporate investment, *Journal of Finance*.
- Malmendier, Ulrike, Geoffrey Tate, and Jon Yan, 2011, Overconfidence and early-life experiences: The effect of managerial traits on corporate financial policies *Journal of Finance*.
- Schneider, Christoph, and Oliver Spalt, 2016, Conglomerate Investment, Skewness, and the CEO Long Shot Bias, *Journal of Finance*.

**Limits of Arbitrage – Theory**

• Liu, Jun, and Francis Longstaff, Losing money on arbitrage: Optimal dynamic portfolio choice in markets with arbitrage opportunities, Review of Financial Studies.

Limits of Arbitrage – Empirical
• Ljungqvist, Alexander, and Wenlan Qian, 2016, How constraining are limits to arbitrage, Review of Financial Studies.
• Ofek, Eli and Matthew Richardson, 2003, DotCom mania: The rise and fall of Internet stocks, Journal of Finance.
• Pontiff, Jeffrey, 2006, Costly arbitrage and the myth of idiosyncratic risk, Journal of Accounting and Economics.

Behavioral Models

Prospect Theory
• Barberis, Nicholas, and Ming Huang (2001), Mental accounting, loss aversion and individual stock returns, Journal of Finance.
• Barberis, Nicholas, Ming Huang, and Tano Santos, 2001, Prospect theory and asset prices, Quarterly Journal of Economics.

Li, Yan, and Liyan Yang, 2013, Prospect theory, the disposition effect, and asset prices, *Journal of Financial Economics*.


**Sentiment**


**Overconfidence**

- Scheinkman, Jose, and Wei Xiong, 2003, Overconfidence and speculative bubbles, *Journal of Political Economy*.

**Other**
• Barberis, Nicholas, Ming Huang, and Richard H. Thaler, 2006, Individual preferences, monetary gambles, and stock market participation: A case for narrow framing, American Economic Review.

Tests of Behavioral Models

Prospect Theory
• Grinblatt, Mark, and Bing Han, 2005, Prospect Theory, Mental accounting, and momentum, Journal of Financial Economics.

Sentiment


• Han, Bing, 2008, Investor sentiment and option prices, Review of Financial Studies.


• Tetlock, Paul, 2007, Giving content to investor sentiment: The role of media in the stock market, Journal of Finance.


Comovement


• Kuhnen, Camelia, 2015, Asymmetric Learning from Financial Information, *Journal of Finance*.
• Kumar, Alok and Charles Lee, 2006, Retail investor sentiment and return comovements, *Journal of Finance*.

**Misreaction**

• Poteshman, Allen M., 2001, Underreaction, overreaction, and increasing misreaction to information in the options market, *Journal of Finance*.
• Tetlock, Paul, 2011, All the news that’s fit to reprint: Do investors react to stale information? *Review of Financial Studies*.

**Attention**


Rashes, Michael S., 2001, Massively confused investors making conspicuously ignorant choices (MCI-MCIC) *Journal of Finance*.


Lotteries


Bakshi, Xiaohui Gao, and Tse-Chun Lin, 2014, Do Individual Investors Treat Trading as a Fun and Exciting Gambling Activity? Evidence from Repeated Natural Experiments,


• Green, T. Clifton and Byoung-Hyoun Hwang, 2012, IPOs as lotteries: Skewness preference and first-day returns, Management Science.

• Han, Bing, and Alok Kumar, 2013, Speculative retail trading and asset prices, Journal of Financial and Quantitative Analysis.

• Mitton, Todd, and Keith Vorkink, 2010, Why do firms with diversification discounts have higher expected returns?, Journal of Financial and Quantitative Analysis.

Culture/Trust


• (22) Bottazzi, Laura, Marco Da Rin, and Thomas Hellmann, 2016, The Importance of Trust for Investment: Evidence from Venture Capital, Review of Financial Studies.

• Chang, Yen-Cheng, Harrison Hong, Larissa Tiedens, and Bin Zhao, 2013, Does diversity lead to diverse opinions? Evidence from languages and stock markets, Working paper, Princeton University.


Other