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 six 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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<td>Overview of Behavioral Biases</td>
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<td>Fall Break</td>
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<td>Tests of Behavioral Models – Sentiment, Comovement</td>
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<td>13</td>
<td>12/8</td>
<td>Tests of Behavioral Models – Misreaction</td>
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<td>14</td>
<td>12/15</td>
<td>Tests of Behavioral Models – Attention, Lotteries</td>
<td>(23, 24)</td>
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Readings

Overview

Surveys


Commentaries


Investor Behavior

Portfolio Contraction


Home Bias


Trading


Attention


Weather


Corporate Finance – Manager Behavior

Manager Response to Investor Biases

Manager Bias

Limits of Arbitrage – Theory

Limits of Arbitrage – Empirical


Behavioral Models

Prospect Theory


• Li, Yan, and Liyan Yang, 2008, “Prospect Theory, the Disposition Effect and Asset Prices, Working Paper, Cornell.


Sentiment


Overconfidence


**Tests of Behavioral Models**

Prospect Theory


Sentiment


Comovement


Misreaction


Attention


Lotteries


❖ (24) Han, Bing, and Alok Kumar, 2008, “Retail clienteles and the idiosyncratic volatility puzzle,” Working Paper, University of Texas.