Administrative details

Research in the field of behavioral finance tries to improve our understanding of financial markets, investor behavior, and corporate finance using frameworks that are psychologically more realistic than their predecessors – frameworks that, in particular, allow for less than fully rational thinking on the part of some agents in the economy. The emergence of this field is one of the biggest conceptual developments in financial economics over the past 30 years.

The course is aimed at undergraduate and Ph.D. students who would like to learn more about research in the field of behavioral finance. Over the course of the term, we will study dozens of academic papers.

The requirements for the course are: (i) a number of homework assignments, most of which are analytical exercises (30% of the final grade); (ii) a short research proposal describing an idea for future research, due in May 2017 (30% of the final grade); and (iii) a final exam which will test mastery of the material covered in the lectures and in the readings (40% of the final grade).

Note:

- The final exam will be a closed-book take-home exam subject to the Honor Code.
- For copyright protection, please do not redistribute any class notes without instructor permission.
BOOKS

Required:

Recommended:

SURVEY PAPERS

Required:

Recommended:
RESEARCH ARTICLES

Starred articles are required reading. The non-starred readings are optional; even though they are optional, you will learn something from all of them, so take a look at as many of them as you can.

References to a Survey in the reading list refer to the survey paper of Barberis and Thaler (2003), listed above.

PART I: FACTS

FACTS: ASSET PRICING

*Inefficient Markets*, Chapter 1.


**FACTS: INVESTOR BEHAVIOR**


**FACTS: CORPORATE FINANCE**


PART II: BUILDING BLOCKS (LIMITS TO ARBITRAGE and PSYCHOLOGY)

LIMITS TO ARBITRAGE

*Survey, Sections 1 and 2.

*Inefficient Markets, Chapters 2 and 4 [these are updated versions of DeLong et al. (1990) and Shleifer and Vishny (1997)]


PSYCHOLOGY

(Book)

Aronson, Elliot, Timothy Wilson, and Robin Akert (2007), *Social Psychology*, New York: Prentice Hall [a good introduction to social psychology]


Kahneman, Daniel (2011), *Thinking, Fast and Slow*, Farrah, Straus, and Giroux [a wonderful tour of his work with Tversky]


(Survey articles)

*Survey, Section 3.


(Research articles)


**PART III: MODELS AND PREDICTIONS**

**PART IIIA: MODELS OF INVESTORS**

**PROSPECT THEORY**


**AMBIGUITY AVERSION**


**OTHER UTILITY SPECIFICATIONS**


**HETEROGENEOUS BELIEFS**


OVERCONFIDENCE


OVER-EXTRAPOLATION (and related biases)

*Inefficient Markets*, Chapter 6 [updated version of DeLong et al. (1990) below]


**MODELS WITH GENERAL SENTIMENT**


**BOUNDED RATIONALITY**


PART IIIB: MODELS OF FIRMS

IRRATIONAL INVESTORS AND RATIONAL MANAGERS


**IRRATIONAL MANAGERS**


**PART IV: THE FACTS, REVISITED**

**ASSET PRICING**

*Survey, Sections 4, 5, 6.

**INVESTOR BEHAVIOR**

*Survey, Section 7.
PART V: PRESCRIPTIVE BEHAVIORAL FINANCE


PART VI: CONCLUSION

