Peking University HSBC Business School

FIN 31
Behavioral Finance
Module 3, 2017-2018

Course Information

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Classes:
Lectures: Tuesday & Friday 10:30 – 12:20
Venue: PHBS Building, Room #229

Course Website:

http://cms.phbs.pku.edu.cn/claroline/course/index.php?cid=FIN31

1. Course Description

1.1 Context

Course overview:

Behavioral finance is the study of how psychological phenomena impact financial behavior. It also explores how violations of various tenets sustaining the traditional finance paradigm could lead to what we observe in the financial markets. The main purpose of this course is to provide a broad and extensive knowledge of the behavioral foundations of finance and financial economics and their applications. Behavioral finance is a relatively new but quickly expanding field of mainstream finance that seeks to provide explanations for people's economic decisions which are not exactly consistent with traditional economics and finance. It helps explain a number of seemingly irrational and inconsistent patterns found in investor decisions, financial markets, and corporate managerial behavior, complementing the traditional paradigm. Starting with a review of the standard finance theories, in particular, the efficient market hypothesis, the course examines a variety of financial market phenomena that are hard to explain by traditional theories. We will then turn to more realistic settings of market dynamics and consider alternative theories of financial markets, aiming to better understand and shed some light on the observed behaviors of financial markets and their participants.

Prerequisites:

While there is no formal prerequisite, solid grasp of financial economics at master's level is instrumental. In addition, students are expected to be familiar with basic probability/statistics and econometrics at undergraduate level.

1.2 Textbooks and Reading Materials

- ***Behavioral finance: psychology, decision-making, and markets*** (South-Western Cengage Learning, 2010), Lucy F. Ackert and Richard Deaves
- ***Inefficient markets: An Introduction to Behavioral Finance*** (Oxford University Press, 2000), Andrei Shleifer. ISBN-10: 0198292279; ISBN-13: 978-0198292272.
- ***Asset Pricing*** (Princeton University Press, 2005), ISBN-10: 0691121370, ISBN-13: 978-0691121376.
- ***Microeconomic theory*** (Oxford University Press; 1st edition, 1995 (MWG)), Mas-Colell, Andreu, Whinston, Michael, and Jerry Green. ISBN-10: 0195073401, ISBN-13: 978-0195073409.

2. Learning Outcomes

2.1 Intended Learning Outcomes

Learning Goals	**Objectives**	**Assessment (YES with details or NO)**
1. Our graduates will be effective communicators.	1.1. Our students will produce quality business and research-oriented documents.	
	1.2. Students are able to professionally present their ideas and also logically explain and defend their argument.	
2. Our graduates will be skilled in team work and leadership.	2.1. Students will be able to lead and participate in group for projects, discussion, and presentation.	
	2.2. Students will be able to apply leadership theories and related skills.	
3. Our graduates will be trained in ethics.	3.1. In a case setting, students will use appropriate techniques to analyze business problems and identify the ethical aspects, provide a solution and defend it.	
	3.2. Our students will practice ethics in the duration of the program.	
4. Our graduates will have a global perspective.	4.1. Students will have an international exposure.	
5. Our graduates will be skilled in problem-solving and critical thinking.	5.1. Our students will have a good understanding of fundamental theories in their fields.	
	5.2. Our students will be prepared to face problems in various business settings and find solutions.	
	5.3. Our students will demonstrate competency in critical thinking.	

2.2 Course specific objectives

Students will be able to understand the main concepts underlying behavioral finance; and apply those concepts and skills to their own research. In particular, the course is designed such that they will be able to:

- identify systematic deviations from rational decision making by individuals;
- explain how cognitive limitations, including bounded rationality, affects investment decision making;
- keep themselves updated on the new developments of behavioral finance and facilitate their future research in this area.

2.3 Assessment/Grading Details

Midterm Exam	25%
Final Exam	40%
Term Project/Presentation	25%
Class Attendance/Participation	10%

In-class participation:

A significant amount of material will be covered in each class. Lectures will often go beyond the scope and depth of the textbooks. Therefore, you must attend each and every class and actively participate in the class discussions. If you are unable to attend a class, you are required to submit a written justification in advance. Also it is your responsibility to catch up on the missed lecture material. Absence in two or more lectures will result in a failure for the final grade.

Project:
The term project will consist of a final report and presentation slides on a topic approved by the instructor. Further details will be provided later.

Exams:
Midterm and final exams will be closed-book. Cell phones are not allowed as calculators. No crib sheet is allowed in either exam. Absence from any exam at the scheduled time will result in a grade of zero unless documented justification is provided (e.g., of an illness). Make-ups will NOT be given. Any student who cannot attend an exam must contact me at the earliest possible time PRIOR TO the exam.

3. Academic Honesty and Plagiarism

It is important for a student's effort and credit to be fairly recognized through class assessment. Credits earned using other people's efforts are clearly unfair. Deliberate dishonesty is considered academic misconduct, which includes plagiarism; cheating on assignments or examinations; engaging in unauthorized collaboration on academic work; taking, acquiring, or using test material without instructor's permission; submitting false or incomplete records of academic achievement; acting alone or in cooperation with another to falsify records or to dishonestly obtain grades, honors, awards, or professional endorsement; or altering, forging, or misusing academic records; or fabricating or falsifying data, research procedures, or data analysis.

All assessments are subject to academic misconduct check. Misconduct check may include reproducing assessments, providing copies to another member of the faculty, and/or to the PHBS Discipline Committee. A suspected plagiarized document/assignment submitted to a plagiarism checking service may be kept in its database for future reference purpose.

Where violation is suspected, penalties will be imposed. The penalties for academic misconduct may include: deduction of honour points, a mark of zero on the pertinent assessment, a failing grade for the whole course, and a reference of the matter to the Peking University Registrar.

For more information of plagiarism, please refer to *PHBS Student Handbook*.

4. Topics, Teaching and Assessment Schedule

Week	Topic(s)	Remarks
1	• Class overview • Review of Traditional Finance Paradigm: Theoretical and Empirical Foundations	
2	• Challenges to Market Efficiency • Tests of Efficient Market Hypothesis	
3	• Introduction to Behavioral Finance • Prospect Theory	
4	• Heuristics, Biases, and Their Implications: Framing, Familiarity, Anchoring, Mental Accounting, Reference Dependence, etc.	
5	• Heuristics, Biases, and Their Implications: Framing, Familiarity, Anchoring, Mental Accounting, Reference Dependence, etc.	Midterm exam
6	• Irrational Investors and Investment Behavior: Overconfidence, Optimism, Over- (Under-) reactions, and Their Implications	
7	• Behavioral Corporate Finance and Managerial Decision Making: Overconfidence, Optimism, Over- (Under-) reactions, and Their Implications:	
8	• Anomalies and Behavioral Explanations: Equity Premium Puzzle and Myopic Loss Aversion, Asset Price Bubbles, Momentum, Trading Volume and Excess Volatility Puzzle	
9	• Behavioral Finance and Asset Pricing	Final Exam: April 27 (Fri.)

Reading List:

Weeks 1&2

Barberis, N., and R. Thaler, 2003, “A Survey of Behavioral Finance”, in: Constantinides, G., M. Harris, and R. Stulz, *Handbook of the Economics of Finance: Financial Markets and Asset Pricing*, North Holland, Amsterdam, 1053-1124.

Della Vigna, S., 2009, "Psychology and Economics: Evidence from the Field", *Journal of Economic Literature*, 47, 315-372.

Rabin, M., 1998, "Psychology and Economics", *Journal of Economic Literature*, 36, 11-46.

Rabin, M. and R. Thaler, 2001, "Anomalies: Risk aversion", *Journal of Economic Perspectives*, 15, 219-32.

Mendel, B., and A. Shleifer, 2012, “Chasing Noise”, *Journal of Financial Economics*, 104, 303-320.

Shleifer, A., and R. W. Vishny, 1997, “The Limits of Arbitrage”, The Journal of Finance, 52, 35-55.

Week 3

Kahneman, D., and A. Tversky, 1979, “Prospect Theory: An Analysis of Decisions Under Risk”, *Econometrica*, 47, 263-291.

Kahneman, D., J. L. Knetsch, and R. Thaler, 1991, “Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias”, *Journal of Economic Perspectives*, 5, 193-206.

Baker, M., X. Pan, and J. Wulgler, 2012, “The effect of reference point prices on mergers and acquisitions”, *Journal of Financial Economics*, 106, 49-71.

Week 4

Tversky, A., and D. Kahneman, 1971, “Belief in the Law of Small Numbers”, *Psychological Bulletin*, 76, 105-110.

Tversky, A., and D. Kahneman, 1986, “Rational Choice and the Framing of Decisions”, The Journal of Business, 59, Part 2: *The Behavioral Foundations of Economic Theory* (Oct., 1986), pp. S251-S278.

Barberis, N., and W Xiong, 2009, “What Drives the Disposition Effect? An Analysis of a Long-Standing Preference-Based Explanation”, *Journal of Finance*, 64, 1747-1764.

Grinblatt, M., M. Keloharju, and J. Linnainmaa, 2012, “IQ trading behavior, and performance”, *Journal of Financial Economics*, 104, 339-362.

Odean, T., 1998, “Are Investors Reluctant to Realize Their Losses?”, *Journal of Finance*, 53, 1775-1798.

Shefrin, H., and M. Statman, 1985, “The Disposition to Sell Winners Too Early and RideLosers Too Long: Theory and Evidence”, *Journal of Finance*, 40, 777-90.

Shapira, Z., and I. Venezia, 2001, “Patterns of Behavior of Professionally Managed and Independent Investors”, *Journal of Banking and Finance*, 25, 1573-87.

Week 5

Coval, J. D., and T. Shumway, 2005, "Do Behavioral Biases Affect Prices?", The Journal of Finance, 60, 1–34.

Huberman, G., 2001, "Familiarity breeds investment", *Review of Financial Studies*, 14, 659-680.

Huberman, G., and W. Jiang, 2006, "Offering versus choice in 401(K) plans: Equity exposure and number of funds", *Journal of Finance*, 61, 763-801.

French, K. R., and J. M. Poterba, 1991, "Investor Diversification and International Equity Markets", *The American Economic Review*, 81, 222-226.

Bruno S., and L. Zuo, 2017, "Relative Optimism and the Home Bias Puzzle", Review of Finance, 21, 2045-2074.

Week 6

Barber, B. M., and T. Odean, 2000, "Trading is hazardous to your wealth: The common stock investment performance of individual investors", *Journal of Finance*, 55, 773-806.

Grinblatt, M., and M. Keloharju, 2009, "Sensation Seeking, Overconfidence, and Trading Activity", *Journal of Finance*, 64, 549-578.

Odean, T., 1999, "Do investors trade too much?", *American Economic Review*, 89, 1279-1298.

Poteshman, A., 2001, "Underreaction, Overreaction, and Increasing Misreaction to Information in the Options Market", The Journal of Finance, 56, 851-876.

Week 7

Ben-David, I, J. Graham, and C. Harvey, 2014' "Managerial Miscalibration", Quarterly Journal of Economics, 128, 1547-1584.

Malmendier, U., and G. Tate, 2005a, "CEO Overconfidence and Corporate Investment", Journal of Finance, 60, 2661-2700.

Malmendier, U., and G. Tate, 2008, "Who makes acquisitions? CEO overconfidence and the market's reaction", Journal of Financial Economics, 89, 20-43.

Malmendier, U., Tate, G., and J. Yan, 2011, "Overconfidence and Early-Life Experiences: The Effect of Managerial Traits on Corporate Financial Policies", The Journal of Finance, 66, 1687-1733.

Week 8

Baker, M., and J. Wurgler, 2006, "Investor sentiment and the cross-section of stock returns", *Journal of Finance*, 61, 1645-1680.

Barberis, N., A., Shleifer, and R. Vishny, 1998, "A model of investor sentiment", *Journal of Financial Economics*, 49, 307-343.

Chiang, T. C., and D. Zheng, 2010, "An empirical analysis of herd behavior in global stock markets", *Journal of Banking and Finance*, 34, 1911-1921.

Daniel, K., D. Hirshleifer, and A. Subrahmanyam, 1998, "Investor psychology and security market under- and overreactions", *Journal of Finance*, 53, 1839-1885.

Hong H., and J. Stein, 1999, “A Unified Theory of Underreaction, Momentum Trading, and Overreaction in Asset Markets”, Journal of Finance, 54, 2143-2184.

De Bondt W., and R. Thaler, 1985, “Does the stock market overreact?”, *Journal of Finance*, 40, 793-808.

De Bondt. W., and R. Thaler, 1987, “Further evidence on investor overreaction and stock market seasonality”, Journal of Finance, 42, 557-581.

Mehra, R., and E. C. Prescott, 1985, “The Equity Premium: A Puzzle”, Journal of Monetary Economics, 15, 145-161.

Week 9

Barberis, N., Huang M., and T. Santos, 2001, “Prospect theory and asset prices”, Quarterly Journal of Economics, 116, 1-53.

Lee J., S. Kim, and Y.J. Park, 2017, “Investor Sentiment and Credit Default Swap Spreads During the Global Financial Crisis”, The Journal of Futures Markets, 37, 660-688.

Stambaugh, R., J., Yu, and Y. Yuan, 2012, “The short of it: Investment sentiment and anomalies”, the Journal of Financial Economics, 104, 288-302.

Stambaugh, R., J., Yu, and Y. Yuan, 2014, “The long of it: Odds that investor sentiment spuriously predicts anomaly returns”, the Journal of Financial Economics, 114, 613-619.

Stambaugh, R., J., Yu, and Y. Yuan, 2015, “Arbitrage Asymmetry and the Idiosyncratic Volatility Puzzle”, The Journal of Finance, 70, 1903-1948.

Stambaugh, R., and Y. Yuan, 2017, “Mispricing Factors”, Review of Financial Studies, 30, 1270-1315.