Behavioral Finance
Economics 970

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Location: TBA
Time: TBA

Course Description:

Behavioral finance argues that many facts about asset prices, investor behavior, and managerial behavior are best understood in models where at least some agents are not fully rational. This course will start by working through several survey articles that will give students a feel for the different strands of behavioral finance research.

The first section of the course will cover limits to arbitrage. Efficient markets theory argues that smart investors will quickly reverse any dislocations caused by irrational investors. The theory of limits to arbitrage suggests a number of reasons why this might not be the case. We will spend a total of five classes going over the theory and evidence related to limits to arbitrage, and then we will spend a sixth class discussing the Dotcom bubble, since that time period provides great examples of limits to arbitrage at work.

The second section of the course looks at persistent decision-making biases that have been documented by psychologists. Much of behavioral finance consists of theorists making predictions about asset pricing given that at least some investors have one or more of these decision-making biases.

The third section covers investor behavior, and the fourth section covers behavioral corporate finance. Miscellaneous topics such as IPOs, agency problems in investment management, and the performance of investment managers, will be interspersed throughout the semester.

The course will feature extensive discussion of recent events such as LTCM, the dotcom bubble, and Enron. The last five years have provided ample demonstration of the concepts of behavioral finance, and have led in no small part to behavioral finance becoming the mainstream within the profession.

Course Requirements:

Class Participation: 35% of grade. Attendance is mandatory.

Short Papers. 20% of grade. Two short papers (6-8 pages, double-spaced). One of the papers will be a literature summary of one of the major strands of behavioral finance. The other paper will be either: a short empirical study of a behavioral finance phenomena of interest, or a short paper relating behavioral finance theory to an event in US financial history.
Empirical Paper. 15% of grade. This paper will require you to conduct statistical tests on a phenomena of interest and report the results. It will be expected that your statistical tests are well motivated by theory.

Final Paper. 30%. 12-16 pages, double-spaced. You will be given several different options for your final paper. It can be expected that all of the options will involve some data work.

Course Policies:

Attendance. Attendance is mandatory at all regular class meetings. Exceptions for personal or family emergencies will be granted on a case-by-case basis.

Tardiness. No assignment will be accepted beyond the announced deadline. As with attendance, exceptions of personal or family emergencies will be made on a case-by-case basis.

Office hours. I will be available for office hours for 30 minutes after every class. If additional time is needed, please email me at badams@hbs.edu.

Required Text:


Recommended Texts:

The Winner’s Curse. Richard Thaler.

Assignment Schedule:

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<td>Short Paper #1</td>
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Readings:

There will not be a coursepack for this course. I will send out an electronic version of the syllabus that will contain web links to most of the papers covered. Every week, I will send out an email that will have links to all of the papers covered. Students will be expected to print out these papers. They will never be asked to photocopy articles from a journal or book. Sometimes I will
provide photocopies of the readings to be covered a couple of classes in advance. Throughout the semester, I will give out detailed lists of supplementary readings that the student can keep for future reference.

- * denotes required reading. Other readings are recommended.

Course Schedule:

1. Overview of Behavioral Finance

   There is a close correspondence between this survey and the syllabus that Prof. Barberis uses for his behavioral finance course at UChicago. 
   http://gsbwww.uchicago.edu/fac/nicholas.barberis/teaching/
   Barberis’ syllabus provides the best behavioral finance reading list I have seen. 
   Another good one is available at…
   An excellent set of lecture notes on behavioral finance can be found at…
   http://frankschmid.com/bf.htm

2. Overview of Behavioral Finance (cont.)

   This is another survey of behavioral finance. It complements the Barberis/Thaler article nicely. Barberis and Thaler provide a broad overview of the field, while Hirshleifer focuses on investor psychology.

   Background: 
   Inefficient Markets. Andrei Shleifer. Ch. 1

3. Overview of Behavioral Finance (cont.)

   *Eugene Fama. Market Efficiency, Long-Term Returns, and Behavioral Finance. 

4. Limits to Arbitrage: Theory

   Survey, pp. 2-8.
   Inefficient Markets, Ch. 2, 4.
5. Limits to Arbitrage: Theory (cont.)

*Inefficient Markets*, Ch. 2, 4.

6. Limits to Arbitrage: Evidence

Survey, pp. 8-11.

7. Limits to Arbitrage: Evidence (cont.)


8. Short-Sale Constraints

*“The Market for Borrowing Stock”.  Gene D’Avolio.  

9. Discussion of the Dotcom Bubble

*“The Dotcom Bubble: The Rise and Fall of Internet Stock Prices”.  Eli Ofek, 
Matt Richardson  
http://www.courses.fas.harvard.edu/~ec2728/Papers/Ofek_Richardson_2002.pdf

*Devil Take the Hindmost*.  Edward Chancellor.  Ch 8, 9,  
*Inefficient Markets*.  Shleifer, Ch 2.  

*“How the Eggheads Cracked”* Michael Lewis

A Powerpoint presentation on this paper is available at…
http://papers.nber.org/papers/W5909
*When Genius Failed*. Roger Lowenstein.

11. IPOs


12. Khaneman and Tversky


13. Investor Psychology


14. Overreaction and Momentum


15. Shleifer vs. Fama


16. Investor Behavior

*Survey*, pp. 47-52.

17. Investor Behavior (cont.)


18. Behavioral Corporate Finance


19. Behavioral Corporate Finance (cont.)


20. Behavioral Corporate Finance (cont.)


21. Short-selling and Returns


22. Value vs. Growth
