ECON 4470 Economics of Behavioral Finance

Lecture: Tue 10:30-1:15am ELB 303

Instructor:	Vinci Chow (vincichow@cuhk.edu.hk)
Office hours:	Tue 3-4pm ELB 1004
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Purpose of this Course

This course introduces you to the field of behavioral finance. Starting off with various topics in standard financial economics, we gradually explore implications of non-standard behavioral assumptions. We will cover both theoretical and empirical aspects of the field.

Learning Outcomes

Upon completing this course, students will be able to demonstrate an understanding of the key behavioral assumptions in economics and finance, argue for and against the plausibility of the theories, and recognize how behavioral theories were tested and applied empirically.

Textbook

There is no required textbook for the course—you will only be tested on materials covered in class.

Stata

Some problem sets will require you to do empirical analysis.

Tentative Grading

Assignments	- 30%
Midterm	- 35%
Final	- 35%

Assignments
There will be 4-6 assignments throughout the course. Short assignments will be graded on a scale of check-plus-check-check-minus. There may be up to two long assignments that will be graded on a numerical scale.

Make up exam
A student who does not show up in an exam will be given a zero for that exam. Except in an emergency, I do not want to give make-up exams.

Re-grades
If you feel that an error has been made in the grading of the question on an examination you are can submit the exam in question for a regrade. Regrade requests have to be submitted no more than one week after the examination in question was returned to you. Please note that the entire exam will be reviewed for accuracy.

Tentative Class Schedule

Week 1-2
- Review of standard asset pricing models
- The Deposition Effect: Reference-Dependent Preference

Week 3-4
- Does CAPM works in practice?
- Fama-French Three-Factor Model
- Anticipatory Utility

Week 5-6
- Teaser Interest Rate: Time-inconsistency
- Savings and Retirement: Default Options
- Effects of Commitment Devices on Savings

Week 7
- Ambiguity Aversion

Week 8
- TBA

Week 9
- Midterm Exam (March 9th)

Week 10-11
- Mental Accounting
- Overconfidence
- Efficiency of Market: Noise Traders and Momentum Traders

Week 12-13
- The Close-End Fund Puzzle
- Behavioral Models in Corporate Finance

April 16th
- Final Exam

Tutorial Dates

TBA

Recommended Readings (Not Required for Examinations)

Week 1-2

1. Benartzi, Shlomo and Richard H. Thaler. "Myopic Loss Aversion and the Equity Premium Puzzle." *Quarterly Journal of Economics*, Vol. 110, No. 1 (Feb., 1995), pp. 73-92.
2. Knetsch, Jack L. "The Endowment Effect and Evidence of Nonreversible Indifference Curves." *American Economic Review*, Vol. 79, No. 5 (Dec., 1989), pp. 1277-1284.
3. Kahneman, Daniel and Amos Tversky. "Prospect Theory: An Analysis of Decision under Risk." *Econometrica*, Vol. 47, No. 2 (Mar., 1979), pp. 263-292.
4. Odean, Terrance. "Are Investors Reluctant to Realize Their Losses?" *Journal of Finance*, Vol. 53, No. 5 (Oct., 1998), pp. 1775-1798.
5. Camerer, Colin, Linda Babcock, George Loewenstein and Richard Thaler. "Labor Supply of New York City Cabdrivers: One Day at a Time." *Quarterly Journal of Economics*, Vol. 112, No. 2 (May, 1997), pp. 407-441.

Week 3-4

6. Fama, Eugene "Efficient Capital Markets: A Review of Theory and Empirical Work", *Journal of Finance*, Vol. 25, No. 2 (1970), pp. 383-417.
7. Fama, Eugene, "Efficient Capital Markets II", *Journal of Finance*, Vol. 46, No. 5 (1991), pp. 1575-1617.
8. Fama, Eugene F., Kenneth R. French. "Multifactor Explanations of Asset Pricing Anomalies." *Journal of Finance*, Vol. 51, No. 1 (March 1996), pp. 55-84.

Week 5-6

9. Koszegi, Botond and Paul Heidhues. "Exploiting Naivete about Self-Control in the Credit Market." *American Economic Review*, Vol. 100, No. 5 (2010), pp. 2279-2303.
10. Frederick, Shane, George Loewenstein, and Ted O'Donoghue. "Time Discounting and Time Preference: A Critical Review." *Journal of Economic Literature*, Vol. 40, No. 2 (June 2002), pp. 351-401.
11. James J. Choi, David Laibson, Brigitte C. Madrian and Andrew Metrick. "Reinforcement Learning and Savings Behavior." *Journal of Finance*, Vol. 64, No. 6 (December 2009), pp. 2515-2534.
12. Loewenstein, George, Ted O'Donoghue and Matthew Rabin. "Projection Bias in Predicting Future Utility." *Quarterly Journal of Economics*, Vol. 118, No. 4 (Nov., 2003), pp. 1209-1248.

Week 8-9

13. Choi, James J., Gabriel D. Carroll, David Laibson, Brigitte C. Madrian, and Andrew Metrick. "Optimal Defaults and Active Decisions." *Quarterly Journal of Economics*, November 2009.
14. Thaler, Richard H. and Shlomo Benartzi, "Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving," *Journal of Political Economics*, 2004, Vol. 112, pp. 164–187.
15. Ashraf, Nava, Dean Karlan, and Wesley Yin, "Tying Odysseus to the Mast: Evidence from a Commitment Savings Product in the Philippines," *Quarterly Journal of Economics*, May 2006, Vol. 121, 635–672.
16. Mischel, W., Shoda, Y., & Rodriguez, M. L. "Delay of Gratification in Children." *Science*, Vol. 244 (1989), pp. 933-938.
17. Ariely, Dan and Klaus Wertenbroch. "Procrastination, Deadlines, and Performance: Self-Control by Precommitment." *Psychological Science*, Vol. 13 (May 2002), pp. 219–224.

Week 10-11

18. Bernartzi, Shlomo and Richard H. Thaler. "Risk Aversion or Myopia? Choices in Repeated Gambles and Retirement Investment." *Management Science*, Vol. 45 (1999): pp. 364-381.
19. Choi, James J., David Laibson and Brigitte C. Madrian. "Mental Accounting in Portfolio Choice: Evidence from a Flypaper Effect." *American Economic Review*, 2009.
20. Barber, Brad M. and Terrance Odean. "Trading Is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors." *The Journal of Finance*, Vol. 55, No. 2 (Apr., 2000), pp. 773-806.

21. Buehler, R., Griffin, D., & Ross, M. “Exploring the "planning fallacy": Why people underestimate their task completion times.” *Journal of Personality and Social Psychology*, Vol. 67 (1994), pp. 366-381.
22. Svenson, Ola. “Are We All Less Risky and More Skillful than Our Fellow Drivers?” *Acta Psychologica*, Vol. 47 (1981), pp. 143-148.
23. Dunning, D., Griffin, D., Milojkovic, J. D., & Ross, L. “The Overconfidence effect in Social Prediction.” *Journal of Personality and Social Psychology*, Vol. 58 (1990), pp. 568-581.
24. Hong, Harrison and Jeremy C. Stein. “A Unified Theory of Underreaction, Momentum Trading, and Overreaction in Asset Markets.” *The Journal of Finance*, Vol. 54, No. 6 (Dec., 1999), pp. 2143-2184.
25. De Long, J. Bradford, Andrei Shleifer, Lawrence H. Summers and Robert J. Waldmann. “The Survival of Noise Traders in Financial Markets.” *Journal of Business*, Vol. 64 No. 1 (1994), pp. 1-19.

Week 12-13

26. Chen, Nai-Fu, Raymond Kan, and Merton H. Miller, 1993, “Are the Discounts on Closed-End Funds a Sentiment Index”, *Journal of Finance*, Vol. 48, No. 2, pp. 795-800.
27. Chopra, Lee, and Andrei Shleifer, 1993, “Yes, Discounts on Closed-End Funds are a Sentiment Index”, *Journal of Finance*, Vol. 48, No. 2, pp. 801-808.
28. Lee, Charles M.C., Andrei Shleifer, and Richard H. Thaler, 1991, “Investor Sentiment and the Closed-End Fund Puzzle”, *Journal of Finance*, Vol. 46, No. 1, pp. 75-109.
29. Tirole, Jean. *The Theory of Corporate Finance*. Selected Chapters.