ECON 4470 Economics of Behavioral Finance

Lecture: Tue 10:30-1:15am CC Library CK TSE

Instructor:	Vinci Chow (vincichow@cuhk.edu.hk)
Office hours:	By appointment (https://www.econ.cuhk.edu.hk/booked/)
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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.

Data Analytics

Some problem sets will require you to do empirical analysis. We will have demonstrations in class before each such assignment.

Tentative Grading

Assignments	- 20%
Term Paper	- 50%
Final	- 30%

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.

Term Paper

You will need to write and present a short paper on behavioral economics or behavioral finance. Samples from previous years will be provided on Blackboard.

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

Week 5
- Ambiguity Aversion

Week 6-7
- Teaser Interest Rate: Time-inconsistency
- Savings and Retirement: Default Options
- Effects of Commitment Devices on Savings

Week 8
- Analyst Recommendation

Week 9
- Law of Small Numbers

Week 10
- Investor Sentiment
- Efficiency of Market: Noise Traders and Momentum Traders
- The Close-End Fund Puzzle

Week 11
- Overconfidence
- Behavioral Models in Corporate Finance

Week 12-13
- Term Paper Presentations

Recommended Readings (Not Required for Examinations)

Please refer to the lecture slides for each class's reading recommendations.

Ariely, D., & Wertenbroch, K. (2002). Procrastination, Deadlines, and Performance: Self-Control by Precommitment. *Psychological Science, 13*, 219-224.

Ashraf, N., Karlan, D., & Yin, W. (2006). Tying Odysseus to the Mast: Evidence from a Commitment Savings Product in the Philippines. *Quarterly Journal of Economics, 121*, 635-672.

Barber, B. M., & Odean, T. (2000). Trading Is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors. *Journal of Finance, 55*(2), 773-806.

Benartzi, S., & Thaler, R. H. (1995). Myopic Loss Aversion and the Equity Premium Puzzle. *Quarterly Journal of Economics, 110*(1), 73-92.

Bernartzi, S., & Thaler, R. H. (1999). Risk Aversion or Myopia? Choices in Repeated Gambles and Retirement Investment. *Management Science, 45*, 364-381.

Buehler, R., Griffin, D., & Ross, M. (1994). Exploring the "planning fallacy": Why people underestimate their task completion times. *Journal of Personality and Social Psychology, 67*, 366-381.

Camerer, C., Babcock, L., Loewenstein, G., & Thaler, R. (1997). Labor Supply of New York City Cabdrivers: One Day at a Time. *Quarterly Journal of Economics, 112*(2), 407-441.

Chen, N.-F., Kan, R., & Miller, M. H. (1993). Are the Discounts on Closed-End Funds a Sentiment Index. *Journal of Finance, 48*(2), 795-800.

Choi, J. J., Carroll, G. D., Laibson, D., Madrian, B. C., & Metrick, A. (2009). Optimal Defaults and Active Decisions. *Quarterly Journal of Economics*.

Choi, J. J., Laibson, D., Madrian, B. C., & Metrick, A. (2009). Reinforcement Learning and Savings Behavior. *Journal of Finance, 64*(6), 2515-2534.

Choi, J. J., Laibson.David, & Madrian, B. C. (2009). Mental Accounting in Portfolio Choice: Evidence from a Flypaper Effect. *American Economic Review*.

Chopra, N. L., Shleifer, A., & Thaler, R. H. (n.d.). Yes, Discounts on Closed-End Funds are a Sentiment Index. *Journal of Finance, 48*(2), 801-808.

De Long, J. B., Shleifer, A., Summers, L. H., & Waldmann, R. J. (1994). The Survival of Noise Traders in Financial Markets. *Journal of Business, 64*, 1-19.

Dunning, D., Griffin, D., Milojkovic, J. D., & Ross, L. (1990). The Overconfidence effect in Social Prediction. *Journal of Personality and Social Psychology, 58*, 568-581.

Fama, E. (1991). Efficient Capital Markets II. *Journal of Finance, 46*(5), 1575-1617.

Fama, E., & French, K. R. (1996). Multifactor Explanations of Asset Pricing Anomalies. *Journal of Finance, 51*(1), 55-84.

Frederick, S., Loewenstein, G., & O'Donoghue, T. (2002). Time Discounting and Time Preference: A Critical Review. *Journal of Economic Literature, 40*(2), 351-401.

Hong, H., & Stein, J. C. (1999). A Unified Theory of Underreaction, Momentum Trading, and Overreaction in Asset Markets. *Journal of Finance, 54*(6), 2143-2184.

Kahneman, D., & Tversky, A. (1979). Prospect Theory: An Analysis of Decision under Risk. *Econometrica, 47*(2), 263-292.

Knetsch, J. L. (1989). The Endowment Effect and Evidence of Nonreversible Indifference Curves. *American Economic Review, 79*(5), 1277-1284.

Koszegi, B., & Heidhues, P. (2010). Exploiting Naivete about Self-Control in the Credit Market. *American Economic Review, 100*(5), 2279-2303.

Lee, C. M., Shleifer, A., & Thaler, R. H. (1991). Investor Sentiment and the Closed-End Fund Puzzle. *Journal of Finance, 46*(1), 75-109.

Loewenstein, G., O'Donoghue, T., & Rabin, M. (2003). Projection Bias in Predicting Future Utility. *Quarterly Journal of Economics, 118*(4), 1209-1248.

Mischel, W., Shoda, Y., & Rodriguez, M. L. (1989). Delay of Gratification in Children. *Science, 244*, 933-938.

Odean, T. (1998). Are Investors Reluctant to Realize Their Losses? *Journal of Finance, 53*(5), 1775-1798.

Svenson, O. (1981). Are We All Less Risky and More Skillful than Our Fellow Drivers? *Acta Psychologica, 47*, 143-148.

Thaler, R. H., & Benartzi, S. (2004). Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving. *Journal of Political Economics, 112*, 164–187.