BEHAVIOURAL FINANCE

Course code	*GRAE022*
Course title	*Behavioural Finance*
Type of course	*Compulsory*
Year of study	*MSc 2nd year*
Semester	*Winter 2018*
Number of credits / ECTS	*6 ECTS* *36 academic hours of lectures/seminars, 124 hours of self-study, 2 hours of consultations*
Lecturer	*Dr. Slavisa Tasic* *slatas@faculty.ism.lt*
Study form	*Full-time (consecutive / evening)*
Course prerequisites	*Market efficiency theory, Microeconomics, Corporate Finance*

Course description:

The course offers an overview of important results of behavioral economics and finance, as well as the implications of these results for the traditional finance theory and practice. Using textbook readings, academic papers, classroom experiments, and case studies, the course introduces and explores the main concepts, research tools and methodologies of behavioral economics on the individual, corporate and financial market level. The course will also introduce some influential critiques of the field and explore the implication of behavioral findings for contemporary financial and economic issues in the world.

Course objectives:

Upon successful completion of this course, students will be able to:

Course learning outcomes (CLO)	Study methods	Assessment methods
CLO1. Understand and apply the main concepts, research tools and methodologies of behavioural finance that help to reveal biases, heuristics, etc. in the decision making process on individual, corporate and financial market level.	Lectures, seminars, discussions, self study, group work, case studies, problem-based learning	Group work, in-class assignments, final exam
CLO2. Present the main results in the field of behavioural finance focusing on financial market processes including market anomalies.	Lectures, seminars, discussions, self study, group work, case studies, problem-based learning	Group work, in-class assignments, final exam
CLO3. Explore behavioural corporate finance, considering financial, investment and dividend policy decisions and contrasting traditional and behavioural approaches	Lectures, seminars, discussions, self study, group work, case studies, problem-based learning	Group work, in-class assignments, final exam
CLO4. Research, prepare and present behavioral finance problems	Lectures, seminars, discussions, self study, group work, case studies, problem-based learning	Group work, in-class assignments, final exam

Course schedule:

Date	Topics	Readings
Oct 8	Introduction Classical and behavioral finance Efficient market hypothesis	B&S: Chapters 1-5.* Shiller, 2003.* Black, 1986. DeLong et al, 1990. Fama & French, 1992. Malloney and Mulherin, 2003.
Oct 10	Choice under certainty Choice under uncertainty The meaning of rationality in economics and finance	B&S: Chapter 8* Cowen, 2001.*

Oct 12	Prospect theory	B&S, Chapter 9* Kahneman & Tversky, 1979.* Barberis, 2013.
Oct 15	Perception biases: anchoring, saliency, framing, sunk-cost bias Inertial effects: endowment, status-quo, disposition	B&S, Chapters 10-11* Kahneman & Tversky, 1974.* Khaneman, Knetsch & Thaler, 1991. Finklestein, 2009. Chetty et al, 2009. Camerer & Weber, 1998. Odean, 1998.
Oct 17	Causality and statistics: representativeness, conjunction fallacy, reading into randomness, small sample bias, probability neglect; Illusions: talent, skill, superiority, validity	B&S, Chapters 12-13* Thaler, 1999. Malmendier & Tate, 2015. Tasic, 2009.
Oct 19	Critique of behavioral economics	Buturovic & Tasic, 2015.* Gigerenzer, 2015.* List, 2004; List, 2011.
Oct 22	Stock market behavior: serial correlation, calendar effects, predictability of stock prices, momentum, equity-premium puzzle;	B&S, Chapters 14-19* DeLong & Magin, 2009.* Barberis & Thaler, 2004. Moskowitz & Vissing-Jorgensen, 2002. Kartashova, 2014.
Oct 24	Neuroeconomics Financial crises: behavioral issues	B&S, Chapter 20* Haldane & Madouros, 2013.* Camerer, Loewenstein & Prelec, 2004. Tasic, 2013. Silver, 2012.
Oct 26	Project Presentations	
Oct 30	Final Exam Final Papers due	

Note:
Items denoted with an asterisk * are essential readings. All listed articles will be addressed and discussed in class, but the contents of the asterisk-marked ones may also be the subject of the final exam.

Assessment methods

Class participation (10%)
Behavioral finance is not a definite body of knowledge but a growing, evolving, and still somewhat speculative discipline. In this course we want to critically examine various aspects of behavioral finance rather than just accept its findings. For this reason it is crucial that you read the assigned papers, raise questions, express disagreements, and actively participate in classroom activities.

Final exam (45%)
A set of open-ended and multiple choice questions. The exam will be closed book. The use of printed material or electronic equipment is **not** allowed.

Group project (45%)
The project can take one of the following forms:

Option 1: A case study of a particular behavioral phenomenon. Choose a decision-making phenomenon, bias or heuristic that you want to explore. Explain the phenomenon, discuss its applications, survey the academic literature on it, and present the empirical evidence found in the literature. The paper should be 10-15 pages long (at 1.5 space, including literature using APA requirements).

Option 2: An experiment designed to test a particular behavioral phenomenon. State a research question related to the course and come up with your own experimental design to answer it. You can use a behavioral concept

existing in the literature or propose a new one. You can perform your experiment in the current classroom or online. The accompanying paper should explain your experiment and findings in the usual academic journal form, and there are no specific length requirements for the paper in this case.

In both cases, the project includes a paper and a presentation. The paper (including the contents of the paper and the quality of the experiment if you choose Option 2) counts for 75% of the project grade. The quality of the presentation itself counts for 25% of the project grade.

The project can be realized in groups of 2 or 3 members, Grading requirements are adjusted by the number of group members (3 member groups are expected to do more than 2 member groups). Along with the final paper, group members will send a consensus estimate of their relative contributions adding to 100. (For example, 55:45, or 60:40 for a 2 member group; or 40:40:20, 33:33:34 for a 3 member group).

Readings

Textbook:

Burton, Edwin and Sunit Shah. 2013. Behavioral Finance: Understanding the Social, Cognitive, and Economic Debates. New Jersay: John Wiley & Sons.

In the course schedule above, this book is referred to as B&S.

Journal Articles:

Barberis, Nicholas. 2013. Thirty Years of Prospect Theory in Economics: A Review and Assessment. *Journal of Economic Perspectives* 27(1): 173–196.

Black, Fisher. 1986. Noise. *Journal of Finance* 41(3): 529-543.

Buturovic, Zeljka and Slavisa Tasic. 2015. Kahneman's Failed Revolution Against Economic Orthodoxy. *Critical Review* 27(2): 127:145.

Camerer, Colin & Martin Weber. 1998. The Disposition Effect in Securities Trading. *The Journal of Economic Behavior and Organization* 33: 167-184.

Camerer, Colin, George Loewenstein and Drazen Prelec. 2004. Neuroeconomics: Why Economics Needs Brains. *The Scandinavian Journal of Economics* 106(3): 555-579.

Chetty, Raj, Adam Looney and Kory Kroft. 2009. Salience and Taxation: Theory and Evidence. *The American Economic Review* 99(4): 1145-1177.

Cowen, Tyler. 2001. “How Do Economists Think about Rationality?” In *Satisficing and Maximizing: Moral Theorists on Practical Reason*, ed. Michael Byron. Cambridge: Cambridge University Press.

DeLong, Brad, Andrew Shleifer, Lawrence Summers and Robert Waldmann. 1990. Noise Trader Risk in Financial Markets. *The Journal of Political Economy* 98(4): 703:738.

DeLong, Brad and Konstantin Magin. 2009. The U.S. Equity Return Premium: Past, Present, and Future. *The Journal of Economic Perspectives* 23(1): 193-208.

Fama, Eugene and Kenneth French. 1992. The Cross-Section of Expected Stock Returns. *The Journal of Finance* 47(2): 427-465.

Finklestein, Amy. 2009. E-Z Tax. Tax Salience and Tax Rates. 2009. *Quarterly Journal of Economics* 124(3): 969-1010.

Gigerenzer, Gerd. 2015. Towards a Rational Theory of Heuristics. Mimeo.

Haldane, Andrew & Vasileios Madouros. 2012. The Dog and the Frisbee. Proceedings – Economic Policy Symposium, Jackson Hole: 109-159.

Kahneman, Daniel and Amos Tversky. 1974. Judgement under Uncertainty: Heuristics and Biases. *Science* 185(4157):1124-1131.

Kahneman, Daniel and Amos Tversky. 1979. Prospect Theory: An Analysis of Decisions under Risk. *Econometrica* 47(2):263-292.

Kahneman, Daniel, Jack Knetsch and Richard Thaler. 1991. Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias. *The Journal of Economic Perspectives* 5(1): 193:206.

Katya Kartashova. 2014. Private Equity Premium Puzzle Revisited. *The American Economic Review* 104(10): 3297-3334.

List, John. 2004. Neoclassical Theory versus Prospect Theory: Evidence from the Marketplace. *Econometrica* 72(2): 615-625.

List, John. 2011. Does Market Experience Eliminate Market Anomalies? The Case of Exogenous Market Experience. *The American Economic Review* 101(3): 313-317.

Malloney, Michael and Harold Mulherin. 2003. The complexity of price discovery in an efficient market: the stock market reaction to the Challenger crash. *The Journal of Corporate Finance* 9(4): 453-479.

Martin, Goerge and Nassim N. Taleb. 2012. How to Prevent Other Financial Crises. *School of Advanced International Studies Review*. Available at SSRN.

Moskowitz, Tobias J., and Annette Vissing-Jorgensen. 2002. The Returns to Entrepreneurial Investment: A Private Equity Premium Puzzle? *The American Economic Review* 92 (4): 745-78.

Odean, Terrance. 1998. Are investors reluctant to realize their losses? *Journal of Finance* 53(5): 1775– 1798.

Shiller, Robert. 2003. From Efficient Markets Theory to Behavioral Finance. *Journal of Economic Perspectives* 17(1): 83–104.

Silver, Nate. 2012. A Catastrophic Failure of Prediction. Chapter 1 in *The Signal and the Noise* by Nate Silver. New York: The Penguin Press.

Tasic, Slavisa. 2013. Mind Matters. *Kyklos* 66(3): 403-416.

Thaler, Richard. 1999. Mental Accounting Matters. *Journal of Behavioral Decision Making* 12:183-206.

Ulrike Malmendier and Geoffrey Tate. 2015. Behavioral CEOs: The Role of Managerial Overconfidence. *Journal of Economic Perspectives* 29(4): 37–60.