



Behavioral Finance

Topics Course: taught by Dr. Stephan Müller (Visiting Professor)

Outline:

In the WS 2018/2019 we provide a topics course on behavioral finance. As a research area behavioral finance subsumes the theoretical and empirical work which challenges the efficient market hypothesis. Its “behavioral” perspective considers the joint consequences of i) limited arbitrage and ii) investors with not-fully rational beliefs or non-standard preferences.

The first part of the course is a lecture which presents important behavioral theories such as (cumulative) prospect theory, regret theory, and reference-dependent preferences. The lecture will be complemented by weekly exercises. The second part is constituted by participants’ presentations in class of one specific topic of behavioral finance. Topics and primary literature will be provided. Participants will have to write a referee report for one selected research paper.

Participants:

This course is primarily intended for students in the second year of the master program. Students in the finance profile of the MEP will have priority. As the number of participants will be limited, a **pre-registration until September the 30th, 2018 is required**. Please send your **transcript** and a **short CV** to sekretariat@finance.uni-freiburg.de.

Prerequisites: *Principles of Finance*

Course Schedule:

- **Wednesdays, 6-8pm, room 2121,**
- **Thursdays, 4-6pm, room 1221.**

The first meeting is scheduled on Wednesday, October 17th, at 6pm, in room 2121 KGII.

ECTS (credit points): 8 ECTS points based on

- Presentation performance,
- A referee report (3-5pp., due to 09.01.2019),
- 60 min. Written exam in December,
- Participation.

The course can be dropped without penalty until **November the 15th, 2018**. Thereafter withdrawal will count as a failed examination attempt!

Topics:

1. Market Efficiency	
Topic 1. a)	The Efficient Markets Theory and the Movement toward Behavioral Finance
Papers	<ul style="list-style-type: none"> • The Efficient Market Hypothesis and its Critics Burton Malkiel (2003), <i>Journal of Economic Perspectives</i> 17, 59-82, • From Efficient Markets Theory to Behavioral Finance Robert Shiller (2003), <i>Journal of Economic Perspectives</i> 17, 83-104.
Topic 1. b)	Market Bubbles – Experimental Evidence
Papers	<ul style="list-style-type: none"> • Bubbles, Crashes, and Endogenous Expectations in Experimental Spot Asset Markets Vernon Smith, Gerry Suchanek, and Arlington Williams (1988), <i>Econometrica</i> 56, 1119-1151, • Bubbles and Experience: An Experiment Martin Dufwenberg, Tobias Lindqvist, and Evan Moore (2005), <i>American Economic Review</i> 95, 1731-1737, • Thar She Bursts: Reducing Confusing Reduces Bubbles Michael Kirchler, Jürgen Huber, and Thomas Stöckel (2012), <i>American Economic Review</i> 102, 865-883.
2. Decision under Uncertainty	
Topic 2. a)	Heuristics, Biases and the Hot-Hand Phenomenon
Papers	<ul style="list-style-type: none"> • Judgment under Uncertainty: Heuristics and Biases Amos Tversky, and Daniel Kahneman (1974), <i>Science</i> 27, 1124-1131, • Does the Basketball Market Believe the „Hot-Hand“? Colin Camerer (1989), <i>American Economic Review</i> 79, 1257-1261, • Do Hot Hands Exist among Hedge Fund Managers? An Empirical Evaluation Jagannathan, R., Malakhov, A., & Novikov, D. (2010), <i>The Journal of Finance</i> 65, 217-255.
Topic 2. b)	Prospect Theory and its Application
Papers	<ul style="list-style-type: none"> • Prospect Theory: An Analysis of Decision under Risk Daniel Kahneman and Amos Tversky (1979), <i>Econometrica</i> 47, 263-291, • Toward a Positive Theory of Consumer Choice Richard Thaler (1980), <i>Journal of Economic Behavior & Organization</i> 1, 39-60.

3. Loss Aversion	
Topic 3. a)	The Equity Premium Puzzle
Papers	<ul style="list-style-type: none"> • An Experiment on Risk Taking and Evaluation Periods Uri Gneezy, and Jan Potters (1997), <i>Quarterly Journal of Economics</i> 112, 631-645, • The Effect of Myopia and Loss Aversion on Risk Taking: An Experimental Test Richard Thaler, Amos Tversky, Daniel Kahneman, and Alan Schwartz (1997), <i>Quarterly Journal of Economics</i> 112, 647-661, • The Equity Premium Puzzle Jeremy Siegel and Richard Thaler (1997), <i>Journal of Economic Perspectives</i> 11, 191-200.
Topic 3. b)	The Endowment Effect
Papers	<ul style="list-style-type: none"> • Experimental Tests of the Endowment Effect and the Coase Theorem Daniel Kahneman, Jack Knetsch, and Richard Thaler (1990), <i>Journal of Political Economy</i> 98, 1325-1348. • Does Market Experience Eliminate Market Anomalies? John List (2003), <i>Quarterly Journal of Economics</i> 118, 41-72.
4. Risk and Ambiguity	
Topic 4. a)	The Role of Risk Preferences
Papers	<ul style="list-style-type: none"> • Risk Aversion and Incentive Effects Charles Holt and Susan Laury (2002), <i>American Economic Review</i> 92, 1644-1655, • Individual Risk Attitudes: Measurement, Determinants, and Behavioral Consequences Thomas Dohmen, Armin Falk, David Huffman, Uwe Sunde, Jürgen Schupp, Gert Wagner (2011), <i>Journal of the European Economic Association</i> 9, 1542-4774.
Topic 4. b)	Ambiguity Aversion & the Home Bias
Papers	<ul style="list-style-type: none"> • Ambiguity Aversion and Comparative Ignorance Craig Fox, and Amos Tversky (1995), <i>Quarterly Journal of Economics</i> 110, 585-603, • Home Bias at Home: Local Equity Preference in Domestic Portfolios Joshua Coval, and Tobias Moskowitz (1999), <i>The Journal of Finance</i> 54, 2045-2073.
Topic 4. c)	Ambiguity Aversion on Markets
Papers	<ul style="list-style-type: none"> • Reaction to Public Information in Markets: How Much does Ambiguity Matter? Brice Corgnet, Praveen Kujal, and David Porter (2013), <i>Economic Journal</i> 123, 699-737, • Does Ambiguity Aversion Survive in Experimental Markets? Sascha Füllbrunn, Holger Rau, and Utz Weitzel (2014), <i>Journal of Economic Behavior & Organization</i> 107B, 810-826.

5. Investor Psychology	
Topic 5. a)	Overconfidence on Financial Markets
Papers	<ul style="list-style-type: none"> Overconfidence of Professionals and Lay Men: Individual Differences Within and Between Tasks? Markus Glaser, Thomas Langer, and Martin Weber (2005), <i>SFB 504 Working Paper</i> 05-25, Boys will be Boys: Gender, Overconfidence, and Common Stock Investment Brad Barber, and Terrance Odean (2001), <i>Quarterly Journal of Economics</i> 116, 261-292.
Topic 5. b)	The Role of Weather Effects
Papers	<ul style="list-style-type: none"> Stock Prices and Wall Street Weather Edward Saunders, Jr. (1993), <i>American Economic Review</i> 83, 1337-45, Weather and Intraday Patterns in Stock Returns and Trading Activity Shao-Chi Chang, Sheng-Syan Chen, Robin Chou, and Yueh-Hsiang Lin (2008), <i>Journal of Banking & Finance</i> 32, 1754-1766, Spanish Stock Returns: Where is the Weather Effect? Angel Pardo, and Enric Valor (2003), <i>European Financial Management</i> 9, 117-126e.
Topic 5. c)	The Influence of Mental Accounting
Papers	<ul style="list-style-type: none"> Mental Accounting Matters Robert Thaler (1999), <i>Journal of Behavioral Decision Making</i> 12, 183-206, Do Investors Integrate Losses and Segregate Gains? Mental Accounting and Investors Trading Decisions Sonya Seongyeon Lim (2006), <i>Journal of Business</i> 79, 2539-2573.
6. Market Phenomena	
Topic 6. a)	Investors and the Disposition Effect
Papers	<ul style="list-style-type: none"> The Disposition to Sell Winners too Early and Ride Losers too Long: Theory and Evidence Hershel Shefrin and Meir Statman (1985), <i>The Journal of Finance</i> 40, 777-790, The Disposition Effect in Securities Trading: An Experimental Analysis Martin Weber and Colin Camerer (1998), <i>Journal of Economic Behavior</i> 33, 167-184, The Disposition Effect in Team Investment Decisions: An Experimental Analysis Holger Rau (2015), Available at SSRN: http://ssrn.com/abstract=2223728.

<p>Topic 6. b)</p> <p>Papers</p>	<p>Herding on Markets</p> <ul style="list-style-type: none"> • Learning from the Behavior of Others: Conformity, Fads and Informational Cascades Sushil Bikchandani, David Hirshleifer, and Ivo Welch (1998), <i>Journal of Economic Perspectives</i> 12, 151-170, • Herding and Contrarian Behavior in Financial Markets: An Internet Experiment Matthias Drehmann, Jörg Oechssler, and Andreas Roeder (2005), <i>American Economic Review</i> 95, 1403-1426, • An Empirical Analysis of Herd Behavior in Global Stock Markets Thomas Chiang, and Dazhi Zheng (2009), <i>Journal of Banking and Finance</i> 34, 1911-1921.
<p>7. The Neuroeconomic Perspective</p>	
<p>Topic 7. a)</p> <p>Papers</p>	<p>How Regret Influences Decision Making</p> <ul style="list-style-type: none"> • Anticipated Regret, Expected Feedback and Behavioral Decision Making Marcel Zeelenberg (1999), <i>Journal of Behavioral Decision Making</i> 12, 93-106, • Brain, Emotion and Decision Making: The Paradigmatic Example of Regret Giorgio Coricelli, Raymond Dolan, and Angela Sirigu (2007), <i>Trends in Cognitive Sciences</i> 11, 258-265, • Interdependent Utilities: How Social Ranking Affects Choice Behavior Nadège Bault, Giorgio Coricelli, and Aldo Rustichini (2008), <i>PLoS one</i> 3.10, e3477.
<p>Topic 7. b)</p> <p>Papers</p>	<p>Hormones and their Impact on Risk Taking and Trust</p> <ul style="list-style-type: none"> • Testosterone and Financial Risk Preferences Coren Apicella, Anna Dreber, Benjamin Campbell, and Peter Gray (2008), <i>Evolution and Human Behavior</i> 29, 348-390. • Oxytocine Increases Trust in Humans Michael Kosfeld, Markus Henrichs, Paul Zak, Urs Fischbacher, and Ernst Fehr (2005), <i>Nature</i> 435, 673-676. • Testosterone Decreases Trust in Socially Naïve Humans Peter Bos, David Terburg, and Jack van Honk (2010), <i>Proceedings of the National Academy of Sciences</i> 107, 9991-9995.