

DEPARTMENT.....: Accounting and Finance (CFC)
 PROGRAM.....: CMCD
 COURSE.....: Behavioral Finance
 PROFESSOR.....: Wesley Mendes
 DAY/HOUR.....: Thursdays, 03:00 pm - 06:50 pm

SEMESTER/YEAR..... 2nd/2016

SYLLABUS

OBJECTIVES AND CONTENTS

This course describes how individuals and firms make financial decisions and how these decisions might deviate from those predicted by traditional financial or economic theories. Students explore the existence of psychological biases in financial decision-making and examine the impacts of these biases in financial markets and other financial settings. The course also examines how the insights of behavioral finance complement the traditional finance paradigm. It will also introduce students to behavioral and experimental methodologies used in finance, economics and other disciplines. In addition, it is expected that students will gain an understanding of how individuals actually make financial decisions (descriptive) and guidance on how to improve their own financial decision making (prescriptive) and others. **Limitations:** Due to time limitations, we will not cover all of the methodological and theoretical backgrounds related to behavioral finance and other related knowledge fields, e.g. neuroeconomics and experimental economics.

FORMAT

This course is a theoretical and empirical evidence course and will be conducted in Portuguese. Lectures and behavioral finance readings will help you learn the economic intuition behind each paper discussed. Course readings will expose you to a theoretical framework that supports behavioral finance knowledge and literature.

Course assignments will require you to use the literature analyzed in the course.

Each one of the seven classes will have the following structure: Introduction to the topic that will be given by means of a 40 minute presentation, and three or four papers presented by students. We will have a 15 minute break after the first presentation. Two of our sessions will start with 30 min quizz. In addition, before each session you will be asked to send your assignment (in respect to each paper discussed) in electronic version. In the end you will need to write a Research Paper as well. I strongly suggest you don't procrastinate.

CONTENT

- Foundations of Finance and Behavioral Finance, Expected Utility Theory
- Heuristics & Biases and Bounded Rationality
- Prospect Theory & SP/A Theory
- Challenges and Violations of Market Efficiency Hypothesis
- Happiness and Neuroeconomics basics & Social forces
- Time Discounting, Consumption, Savings & Insurance
- Behavioral Corporate Finance

GRADING

Presentation/papers discussion:	25
Assignments:	10
Exercises:	10
Quizzes:	40
Final Exam:	40
Research paper:	25
Total	150

The Research Paper (1 week after the course end) is a document describing a specific behavioral corporate finance topic. The paper should be structured according to the format as follows:

- *Introduction*: this section should give an overview of the existing literature, highlighting and describing the original features of the research paper;
- *Scope and research questions*: this paragraph should define (and describe) the scope of the paper and identify the (innovative) research issues to which the paper should provide answers;
- *Methodology*: this section should present a description of the research methods that will be used to compile the paper. The method has to be illustrated taking into account the analysis of the data requirements needed for the research work.
- *Reference list*: a list of the literature (effectively) examined in connection with the paper.

You can identify possible research topics reading the materials suggested in class or this article by Fairchild (2010):

- Fairchild, R. (2010). Behavioural corporate finance: Existing research and future directions. *International Journal of Behavioural Accounting and Finance*, 1(4), 277-293.

ACADEMIC HONESTY POLICY AND OFFICE HOURS

Inappropriate conduct (such as cheating in exams and quizz) is taken seriously, according to the Policy and Ethics Code of FGV. Just in case, if you find it is necessary to find me outside of class time, I may not be available 24/7. Therefore, the service to students could be held on the rest of the week, provided it has been scheduled in advance | Email: wesley.mendes@fgv.br.

COURSE REQUIREMENTS

The course does not have any formal pre-requisites. However, I expect you to have good knowledge of basics of financial decisions, including funding and investment. Students are expected to review the assigned reading materials before each session, work on the assigned problems/questions, and to participate in the class discussions. You should be prepared to spend significant time to digest the material and to work on the assignments. Timely submission of the assigned work is critical. Please kindly use Dropbox/Eclass. Late submissions will not be accepted.

BEST PREPARATION METHOD

You should invariably read the assigned chapters, journal articles and other supplementary materials before you come to the class and go over the assigned exercises. After the end of each session, you should review handouts, your notes and highlights in your readings.

COURSE SCHEDULE AND READING LIST

The sessions are given based on slide presentations, which will be available before each class on Eclass, including course notes. The content considers a variety of sources including various textbooks, journal articles, working papers, and other professors' lecture notes. There is no single required "textbook" but the course will mostly follow the sequence of A&D's book. Notes will be provided based on appropriate references for each lecture on the exhibit below, where the relevant readings for each lecture are shown. Students are expected to read this material prior to the lecture. Additionally, all lectures will contain student presentations of papers related to the current week's lecture topic. A list of papers to be presented is given below.

Each session will cover different (but related) papers. All the students must read all the papers for each session. Each student will make a ~30 minute PowerPoint presentation that discusses the paper, and each presentation will be followed by in-class discussion. The purpose of the assignment is twofold: i) a key way people in academia will come to know (and access) you. So, it's a good idea to get some practice now. And ii), think critically about the papers. To ensure participation following each presentation, each student must also write up one concern

about each of the presented papers and hand these in at the beginning of the class (Assignments). Each student who is giving the presentation will state his concern at the beginning of the discussion. The comments should be very short [2-3 sentences] and designed to do one of the following two things: (a) express his thought about the biggest problem of the paper, and/or (b) identify his concern he might overlook.

I may cold call students to answer a specific question about the paper. If the answer is weak, this will affect his/her grade negatively. This is done to try to reduce moral hazard and avoid free-ride attitude. The guidelines for a good discussion are as follows (you do not have to strictly follow this order, but it may help you in preparing your presentation):

- Briefly describe what the paper does and its findings;
- Make your point about the assumptions and/or identification strategy;
- Suggest improvements;
- Identify eventual gaps or weaknesses. Be critical. You may use your own judgement or the literature related to the subject. In this case, you will be asked to make explicit the papers you referred to.

Session	Date	Topics	Readings & Papers	Presentations	Exercise due
1	Aug4 th	Foundations of Finance and Behavioral Finance, Expected Utility Theory	[V&M]1 (p. 8-20) [CW&S]3 [A&D]1 Reading list Class #1	Class #1	[CW&S]3: Q12-Q17 [A&D]1: Q1-Q5
2	Aug8 th	Heuristics & Biases and Bounded Rationality	[A&D]5;8 [BCLMSS]1 Reading list Class #2	Class #2	N/A
3	Aug18 th	Prospect Theory & SP/A Theory	[A&D]3 [S]2 Reading list Class #3	Class #3	[A&D]3: Q1-Q5
4	Aug25 th	Quiz #1 Challenges and Violations of Market Efficiency Hypothesis	[S]5 [A&D]4, 13, 14 Reading list Class #4	Class #4	N/A
5	Sep1 st	Happiness and Neuroeconomics basics & Social forces	[B&N]5 [A&D]7;11;12;20 HBS ROT038-PDF-ENG HBS ROT098-PDF-ENG Reading list Class #5	Class #5	N/A
6	Sep8 th	Quiz #2 Time Discounting, Consumption, Savings & Insurance	Reading list Class #6	Class #6	N/A
7	Sep15 th	Behavioral Corporate Finance	[A&D]9;16 Reading list Class #7	Class #7	N/A
8	Sep22 nd	FINAL EXAM - 1 st call			
9	Sep29 th	FINAL EXAM - 2 nd call			

Notes: [A&D] = Ackert & Deaves; [B&N] = Baker & Nofsinger; [S] = Shefrin; [V&M] = Von Neumann & Morgenstern; [CW&S] = Copeland, Weston e Shastri.

BOOKS

- [A&D] Ackert, L.F. & Deaves, R. (2010). *Behavioral Finance: Psychology of Decision-Making and Markets*, South-Western Cengage Learning.
- [B&N] Baker, H.K.; Nofsinger, J.R. *Behavioral Finance: Investors, Corporations, and Markets*. Wiley.
- [BCLMSS] Bardsley, N., Cubitt, R., Loomes, G., Moffatt, P., Starmer, C., & Sugden, R. (2009). *Experimental Economics: Rethinking the Rules*. Princeton University Press.
- [BM&A] Brealey, R.A.; Myers, S.C. & Allen, F. (2014). *Principles of Corporate Finance*, 11th edition, Mc Graw Hill Irwin. You can select/buy part of this book at: <http://create.mcgraw-hill.com/createhelp/#page=home.html&type=page&safe=1>, or buy an eBook version at: <https://create.mcgraw-hill.com/shop/#/catalog/details/?isbn=9781121830738>.
- [CW&S] Copeland, T.E.; Weston, J.F.; Shastri, K. (2005). *Financial Theory and Corporate Policy*, 4th ed., New York: Pearson.
- [S] Shefrin, H. (2007). *Behavioral Corporate Finance: Decisions that Create Value*. Mc Graw Hill Irwin.
- [V&M] Von Neumann, J.; Morgenstern, O. (2004). *Theory of Games and Economic Behavior*, New Jersey : Princeton University Press.
- [Slovic] Slovic, P. (2010). *The Feeling of Risk: New Perspectives on Risk Perception*. New York : Routledge.

PAPERS THAT WILL BE DISCUSSED ON TOPICS AROUND BEHAVIORAL FINANCE
Class #1: Foundations of Finance and Behavioral Finance

- Conlisk, J. (1989). Three variants on the Allais example. *American Economic Review*, 73(3), 392-407.
- Fishburn, P.C. (1988). Expected utility: An anniversary and new era. *Journal of Risk and Uncertainty*, 1(3), 267-283.
- Nelson, J.A. (2015). Are woman really more risk-averse than men? A re-analysis of the literature using expanded methods. *Journal of Economic Surveys*, 29(3), 566-585.

Class #2: Heuristics & Biases and Bounded Rationality

- Barberis, N., Shleifer, A., Vishny, R. (1998). A model of investor sentiment. *Journal of Financial Economics*, 49, 307-344.
- Conlisk, J. (1996). Why Bounded Rationality? *Journal of Economic Literature*, 34(2), 669-700.
- Heath, C.; Tversky, A. (1991). Preference and belief: ambiguity and competence in choice under uncertainty. *Journal of Risk and Uncertainty*, 4, 5-28.
- Kahneman, D., Tversky, A. (1972). Subjective probability: A judgement of representativeness. *Cognitive Psychology*, 3, 430-454.
- Tversky, A. Kahneman, D. (1974). Judgement under uncertainty: Heuristics and biases, *Science*, 185, 1124-1131.

Class #3: Prospect Theory & SP/A Theory

- Kahneman, D., Tversky, A. (1979). Prospect theory: an analysis of decision under risk. *Econometrica*, 47(2), 263-291.
- Lopes, L.L. (1987). Between hope and fear: the psychology of risk. *Advances in experimental psychology*, 20, 255-295.
- Lopes, L.L., Oden, G.C. (1999). The role of aspiration level in risky choice: a comparison of cumulative prospect theory and SP/A theory. *Journal of Mathematical psychology*, 43, 286-313.

Class #4: Challenges and Violations of Market Efficiency Hypothesis

- Fama, E.F., Fisher, L. Jensen, M.C., Roll, R. (1969). The adjustment of stock prices to new information. *International Economic Review*, 12, 1-21.
- Conrad, J. Cooper, M., Kaul, G. (2003). Value vs. Glamour. *Journal of Finance*, 58, 1969-1996.
- Griffin, J.M., Ji, X., Martin, S. (2003). Momentum investing and business cycle risk: Evidence from pole to pole. *Journal of Finance*, 63, 2515-2547.
- Grinblatt, M., Han, B. (2004). Prospect theory, mental accounting and momentum. *Journal of Financial Economics*, 78, 311-339.
- Hirshleifer, D. (2001). Investor psychology and asset pricing. *Journal of Finance*, 56, 1533-1597.
- Jagadeesh, N. (1990). Evidence of predictable behavior of security returns. *Journal of Finance*, 45, 881-898.

Class #5: Social forces, Happiness and Neuroeconomics basics

- Fracassi, C., Tate, G.A. (2012). External Networking and Internal Firm Governance. *Journal of Finance*, 67(1), 153-194.
- Dugar, A., Nathan, S. (1995). The effect of investment banking relationships on financial analysts' earning forecasts and investment recommendations. *Contemporary Accounting Research*, 12(1), 131-160.
- Frey, B.S., Stutzer, A. (2002). What Can Economists Learn from Happiness Research? *Journal of Economic Literature*, 40(2).
- Sapra, S.G., Zak, P.J. (2008). Neurofinance: Bridging psychology, neurology and investment behavior. Working Paper available at: <http://ssrn.com/abstract=1323051>
- Lo, A.W., Repin, D.V., Steenbarger, B.N. (2005). Fear and Greed in Financial Markets: A Clinical Study of Day-Traders. *Cognitive Neuroscientific Foundations of Behavior*, 95(2), 352-359.

Class #6: Time Discounting & Consumption, Savings and Insurance

- Angeletos, G-M., Laibson, D., Repetto, A., Tobacman, J., Weinberg, S. (2001). The Hyperbolic Consumption Model: Calibration, Simulation, and Empirical Evaluation. *Journal of Economic Perspectives*, 15(3), 47-68.
- Frederick, S., Loewenstein, G., O'Donoghue, T. (2002). Time Discounting: A Critical Review. *Journal of Economic Literature*, 40, 351-401.
- Metcalfe, J., Mischel, W. (1999). A Hot/Cold System Analysis of Delay of Gratification: Dynamics of Willpower. *Psychological Review*, 106(1), 3-19.
- Mischel, W., Shoda, Y., Rodriguez, M.I. (1989). Delay of gratification in children. *Science*, 244(4907).

Class #7: Behavioral corporate finance & Managerial decision making

- Huang, R., Ritter, J.R. (2009). Testing theories of capital structure and estimating the speed of adjustment. *Journal of Financial and Quantitative Analysis*, 44(2), 237-271.
- Statman, M., Cadwell, D. (1987). Applying behavioral finance to capital budgeting: Project terminations. *Financial Management*, 16(4), 7-15.
- Malmendier, U., Tate, G. (2005). CEO overconfidence and corporate investment. *Journal of Finance*, 60, 2661-2700.