



Sacred Heart UNIVERSITY

JOHN F. WELCH COLLEGE OF BUSINESS

Spring 2015 Syllabus FN 699 - Behavioral Finance

Class Times

Monday,	May 11	6:30 - 9:30pm
Monday,	May 18	6:30 - 9:30pm
Wednesday,	May 20	6:30 - 9:30pm
Monday,	May 25	6:30 - 9:30pm
Wednesday,	May 27	6:30 - 9:30pm
Monday,	June 1	6:30 - 9:30pm
Thursday,	June 4	6:30 - 9:30pm
Friday,	June 5	6:30 - 9:30pm
Monday,	June 8	6:30 - 9:30pm
Wednesday,	June 10	6:30 - 9:30pm
Monday,	June 15	6:30 - 9:30pm
Wednesday,	June 17	6:30 - 9:30pm

Instructor

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Course Motivation

A relatively new field in economics, behavioral finance studies how people's behavior and decision-making process influence their investment choices.

Since the seminal work of Kahneman and Tversky (1974), two schools of thought have been widely accepted as being able to describe and forecast investor behavior: the traditional rational theory, anchored in the Efficient Market Hypothesis and the behavioral approach, which takes into account the effect of social, cognitive and emotional factors on the decision making process.

Proponents of the Efficient Market Hypothesis (rational theory) would claim that markets are fully rational and able to incorporate new information correctly into asset prices. They accept that some abnormality may arise in the formation of asset prices but assume that competition amongst investors trying to take advantage of such abnormalities will drive prices back to their "correct values".

However, empirical studies and the evidence of various apparently irrational speculative bubbles and crashes challenged this view and the new area of behavioral finance came into play.

FN 699 Behavioral Finance

Understanding common behavioral biases investors are likely to be affected by will help you better advise your clients. You will learn why a loss of \$10 might make people feel bad by as much as a \$20 gain makes them feel good. Eventually, outside of finance, a better understanding of behavioral finance will help in understanding apparently irrational consumer behaviors (e.g. why we keep on paying for subscriptions to magazines that we don't even read?) and the influence of cognitive biases in negotiations and information campaigns.

Course Objective

The objective and purpose of this course is to provide an in-depth discussion of the modern development in behavioral finance. Both theory and empirical evidence will be discussed. We will review the decision-making process along with the different biases and paradoxes that go with it, learn about the major theories (Prospect Theory and SP/A Theory), study the formation and burst process of speculative bubbles, and introduce the so-called Behavioral Portfolio Theory (BPT).

Learning Outcomes

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

- identify the common errors in information processing;
- identify the main behavioral biases and heuristics and take them into account when advising a client;
- understand the limits to arbitrage;
- understand the formation and burst process of speculative bubbles;
- Allocate assets in a portfolio according to Behavioral Portfolio Theory.

Textbooks

Behavioural Finance (2009). Williams Forbes. WILEY. ISBN: 978-0-470-02804-9

Supplemental Readings

Advances in Behavioral Finance, Volume II (2005) R.H. Thaler. Princeton University Press

Manias, Panics and Crashes: A History of Financial Crises, Sixth Edition (2007) C.P. Kindleberger and R.Z. Aliber. Palgrave Macmillan.

The Wall Street Journal, Bloomberg, CNN Money

Prerequisite

Elementary statistical skills. Knowledge of portfolio management.

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Grading Policy

The course grade is determined as: 40% Mid-Term Exam and 60% Final Exam.

I will adhere to the following grading scheme:

100-93	A	(4.0)
92-90	A-	(3.67)
89-87	B+	(3.33)
86-83	B	(3.00)
82-80	B-	(2.67)
79-77	C+	(2.33)
76-73	C	(2.00)
72-0	F	(0.00)

Important Time Line

Mid-Term Exam: Monday, June 1

Final Exam: Wednesday, June 17

Attendance Policy

To be successful in this course, attending every class is highly recommended. However, attendance will not be taken at the beginning of each class.

Course Outline

I. Introduction

- A. Traditional vs. Behavioral Theory
- B. The Decision Making Process and Behavioral Biases
- C. Limits to Arbitrage

II. Decision Theory Paradoxes

- A. Nash Equilibrium: Keynesian Beauty Context and The Prisoner's Dilemma
- B. The Monthly Hall Paradox
- C. The St. Petersburg Paradox
- D. The Allais Paradox
- E. The Ellsberg Paradox

III. Behavioral Finance Theory

- A. Prospect Theory
- B. SP/A Theory
- C. Behavioral Portfolio Theory

IV. Bubbles

A. Introduction

B. Empirical and Statistical detection tests

General Information

PowerPoint slides will be used extensively. The set of slides for every class will be available on Blackboard before every class. Please make sure to print them out or to have them on your laptop before class.

We will work on some problems together, so please bring your calculator with you.

Exams will test your understanding of facts, concepts, and problem solving methods. They will be made of three parts: multiple choice questions, problems, and a short essay question. Your score on these exams will mainly depend on your ability to relate fundamental concepts and problem-solving procedures to business situations.

Academic Integrity

Please make sure you understand Sacred Heart's policy on academic integrity and honesty (http://www.sacredheart.edu/pages/734_academic_integrity_policy.cfm), which states:

“Nonetheless, appropriate disciplinary action will be taken for violations of academic integrity, including plagiarism, cheating, any use of materials for an assignment or exam that are not permitted by the instructor, and theft or mutilation of intellectual materials or other University equipment. Faculty will assign failing grades for violations of the University's policy on academic integrity and students may immediately receive an F for a course in which they commit a violation. Violations of academic integrity are kept on file; second violations will bring additional sanctions, up to dismissal from the University. For any disciplinary action, the University affords the student the right of due process in an appeals procedure. All matriculated students will be provided with a full description of the University's standards for academic integrity, the consequences for violations, and the appeals procedure.”

Cheating will not be tolerated in this course. In case of suspected cheating - and as required by College policy - a report of suspected academic dishonesty will be submitted to the Dean of Students office. The student convicted of cheating will receive an F grade for the course.