Akita International University

Global Business Program

Behavioural Finance [ECN420]

Syllabus

Fall Semester, 2020

Instructor

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Office: A4-7 Office Hours: Wednesday 13:00-14:30 or by appointment.

Web: http://dbsg.aiu.ac.jp/html/128_en.html

Scheduled Lecture Times: Monday and Wednesday, 09:00 – 10:15. Lectures will be held synchronously on-line via Zoom. See the detailed schedule at the end of this syllabus.

Course Description:

Conventional models of individual behaviour used in both economics and finance typically describe how people should make decisions, rather than how people actually make choices. Individuals are assumed to be rational and optimise their choices according to a theoretical model describing what they want to achieve. For example, consumers decide which goods to purchase in order to maximise their total satisfaction from consumption, subject to a constrained budget. Proponents of conventional models acknowledge that individuals often behave irrationally, however they propose that at an aggregate level markets operate efficiently "as if" all participants are rational. While conventional models are useful, we often observe evidence in markets that is inconsistent with with the predictions of conventional models.

Behavioural approaches provide an alternative view on economics and finance. Researchers such as Daniel Kahneman (winner of the 2002 Nobel Prize in Economics[1]), Robert Shiller (joint winner of the 2013 Nobel Prize in Economics) and Richard Thaler (winner of the 2017 Nobel Prize in Economics) pioneered the application of concepts from psychology to economic and financial decision-making. In behavioural economics and finance, we use principles from psychology to describe how individuals actually make economic and financial decisions, in contrast to the way rational agent models suggest individuals should make decisions. With behavioural ideas, we can often explain observed market anomalies that have not been explained using conventional theory.

This course trains students in behavioural concepts and their application to investor decision-making, the functioning of financial markets and corporate finance. Behavioural insights are also useful in other areas of business and decision-making. The behavioural concepts we will cover include prospect theory, framing, mental accounting, overconfidence, biases and heuristics, emotions and social forces. During class we will conduct some of the experiments used in behavioural finance research to understand individual decision-making. In addition to learning about behavioural finance, students should also gain insights into their own thinking by understanding how psychology influences their decision-making. An important part of this course is thinking about the way we think, and this can be applied to almost any kind of decision-making.

[1] The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel.

Course Objectives: By the end of the course, students should be able to:

1. Distinguish between the approaches and assumptions of conventional and behavioural finance, and discuss the relationship between the two fields.
2. Explain the behavioural and psychological influences on economic and financial decision-making.
3. Apply behavioural finance research and psychological concepts to problems in finance.
4. Interpret experimental evidence generated by researchers in behavioural economics & finance.

Credits: 3.0

Language: English

Course Format: Synchronous on-line sessions via Zoom during the scheduled lecture times. Use the Zoom link on AIMS to join the sessions. Participation is compulsory. Please observe the AIU rules for on-line classes. in particular, please keep your video on so that we can interact fully during each session.

Experiments: We will do decision-making experiments during the lectures. The aim of doing the experiments is to understand the concepts that we cover in the course and to understand how researchers attempt to test and analyse their behavioural theories. Most of the experiments that we will do are based on published academic research. I will post links on AIMS to the articles related to the experiments. I expect you to read at least the introduction of each article to understand the experiment and related concept. I will give guidance on what parts of the articles you should read.

Evaluation: Performance in the course will be evaluated as follows.

Assignments	20%
Presentation of a published empirical research paper	20%
Exam 1	20%
Exam 2	20%
Exam 3	20%

Assignments: Assignments will be issued about every one to two weeks. The assignments will be coarsely graded on a pass/fail basis. A pass will be awarded for assignments where a reasonable effort has been made and the assignment is submitted on time. Doing the assignments will practice and prepare you for the questions asked in the exams.

Presentation: You will be required to select a published empirical research article on behavioural finance (to be approved by me) and present the article to the class. The presentation should include a 1-page summary of the findings of the research, and presentation slides (both submitted as PDFs). You may conduct an experiment from the article on the class if you wish. The presentation should be about 20 minutes in duration. The article should be published within the last 10 years. The presentation may be done in groups of two. Please read the presentation guidelines for more information. The point of the presentation is for you to have some practice in teaching the class about behavioural finance. Topics covered in the presentations are examinable.

Exams: There will be three exams, focussing primarily on the material in approximately the preceding third of the course. A calculator will be required for the exams. Further instructions and rules of conduct will be provided prior to each exam.

It is your responsibility to make sure you attend the quiz and final exam, and hand in the required assignments and give the presentation on time.

Prerequisites & Preparation: Revise finance theory, probability and statistics. Students who have not taken a finance course may need to supplement their knowledge with self study of relevant topics. Refer to one of the following textbooks:

- Madura, J. (2018). *Financial Markets and Institutions*. South-Western Cengage Learning, 12th edition.
- Pilbeam, K. (2010). *Finance and Financial Markets*. Palgrave Macmillan.
- Mishkin, F. S. (2013). *The Economics of Money, Banking and Financial Markets*. Pearson.
- Cecchetti, S. G. and Schoenholtz, K. L. (2015). *Money, Banking and Financial Markets*. McGraw-Hill.
- Fabozzi, F. J., Modigliani, F., and Jones, F. J. (2014). *Foundations of Financial Markets and Institutions*. Pearson Education.

Required Textbook:

- Ackert, L. F. and Deaves, R. (2010). *Behavioral Finance: Psychology, Decision-Making and Markets*. South-Western Cengage Learning

The e-book version is available from the Cengage e-commerce site (this site is only for AIU students). Instructions on how to purchase and use the e-book are posted on AIMS. Please note that Cengage will not provide a refund for the e-book if you drop the course.

References and Required Readings: References are listed for each topic are listed in the Topic and References Guide. Students are required to read the textbook chapters. Please purchase the textbook. The course will also cover several academic papers and those that are listed as references should be read. In many cases, reading the introduction section and briefly looking over the remainder of the paper will suffice. I will give guidance on the reading in the lectures. There are several short readings from newspapers or the Economist. Links to references (other than the textbook) are provided in this syllabus, or will be made available on AIMS. Links to the experiment articles will also be provided on AIMS after we have completed each experiment, and should be used to supplement the explanation of the experiment in the lecture. Optional reading provides more detailed information on the topic, and is not required but may be useful to gain a deeper understanding of the topic.

Behavioural Economics and Finance Books: The following books are interesting, easy to read and a good way to support your learning during this course. I recommend you read at least one of these books. Listed in order of priority:

- Kahneman, D. (2011). *Thinking, Fast and Slow*. Farrar, Straus and Giroux. [amazon.co.jp]
- Thaler, R. H. (2015). *Misbehaving: The Making of Behavioral Economics*. W.W. Norton. [amazon.co.jp]
- Shiller, R. J. (2015). *Irrational Exuberance*. Princeton University Press.
- Lewis, M. M. (2017). *The Undoing Project: A Friendship that Changed Our Minds*. W.W. Norton.
- Thaler, R. H. and Sunstein, C. R. (2008). *Nudge: Improving Decisions About Health, Wealth and Happiness*. Yale University Press.
- Akerlof, G. A. and Shiller, R. J. (2010). *Animal Spirits: How Human Psychology Drives the Economy and Why it Matters for Global Capitalism*. Princeton University Press.
- Ariely, D. (2010). *Predictably Irrational: The Hidden Forces that Shape Our Decisions*. Harper Perennial.
- Taleb, N. N. (2005). *Fooled by Randomness: The Hidden Role of Chance in Life and in the Markets*. Random House.

Useful Academic Journals: Journals containing empirical behavioural finance research include the major economics and finance journals such as the *Journal of Finance*, *Journal of Financial Economics*, *Journal of Financial and Quantitative Analysis*, *Review of Financial Studies*, *American Economic Review*, plus specialist journals such as the *Journal of Behavioral Finance*, *Journal of Behavioral and Experimental Finance*, *Experimental Economics*, *Journal of Behavioral and Experimental Economics*, *Journal of Economic Behavior and Organisation*, *Journal of Economic Psychology*, *Journal of Risk and Uncertainty*.

Advanced Behavioural Finance Books: The following more advanced books may be useful for reference or further research and study:

- Forbes, W. (2009). *Behavioural Finance*. Wiley.
- Shefrin, H. (2008). *A Behavioral Approach to Asset Pricing*. Academic Press/Elsevier.
- Montier, J. (2007). *Behavioural Investing: A Practitioner's Guide to Applying Behavioural Finance*. John Wiley \& Sons.
- Cartwright, E. (2014). *Behavioral Economics*. Routledge, 2 edition.

Finance Glossary: Investopedia is a useful reference for financial terminology. Finance Textbooks such as Madura (2018) and Pilbeam (2010) also contain lists of financial terms.

Useful Websites: The following behavioural finance-related and other websites are useful references.

- Daniel Kahneman
- Richard Thaler
- Robert Shiller
- Hersh Shefrin
- behaviouralfinance.net
- Workshop in Behavioral Finance
- Journal of Behavioural and Eperimental Finance
- Review of Behavioural Finance
- Freakonomics
- behaviouraleconomics.com
- Chicago Booth Centre for Decision Research

General economics and finance websites:

- Bloomberg
- Reuters
- The Wall Street Journal (subscription required)
- The Financial Times (subscription required)
- The Economist (subscription required)
  - A paper copy of The Economist is available in the Nakajima Library.
- Seeking Alpha
- The Calculating Investor
- Top Economics Blogs
- Yahoo Finance

AIU Academic Dishonesty Policy:
In accord with AIU policies and good practices in higher education, acts of academic dishonesty such as plagiarism, cheating, forgery (on a paper, examination, test, or other assignment) will result in the failure of the course at a minimum. An act of academic dishonesty during the final examination or assignment in lieu of the final examination will result in failure of all courses registered in the relevant academic term. Cases of academic dishonesty will be reported to the Dean of Academic Affairs for relevant action.

Academic misconduct during on-line exams is taken very seriously and will be dealt with strictly. Remember that your good reputation takes a lifetime to build, but it can be destroyed with one stupid act.

Please participate in this course to the fullest extent of your ability and with your highest level of personal and professional integrity.

Topic and References Guide

Topic 1: Course Introduction

References:

- Syllabus.
- Experiment Articles 1 & 2.

Topic 2: Preliminaries - Expected Utility

References:

- Ackert and Deaves (2010), Chapter 1.
- Experiment Article 3.
- For background, refer to an intermediate microeconomics textbook such as Varian (2010).

Topic 3: Preliminaries - Asset Pricing, Market Efficiency and Agency Theory

References:

- Ackert and Deaves (2010), Chapters 2 & 4.
- Harford, T. (2013). How to make money from a Nobel cause. The Financial Times, 25 October.
- Hilsenrath, J. (2004). As two economists debate markets, the tide shifts. *Wall Street Journal*.
- The Economist (2009a). Efficiency and beyond. *The Economist*.
- Experiment Article 4.
- Buttonwood (2014). Risk-taking in finance: Heads they win... *The Economist*.
- Akerlof, G. A. (1970). The Market for "Lemons": Quality Uncertainty and the Market Mechanism. *Quarterly Journal of Economics*, 84(3):488–500. [JSTOR]

  Optional reading:
- Malkiel, B. G. (2003). The Efficient Market Hypothesis and Its Critics. [Link]
- Shiller, R. J. (2010). The Stock Market in Historical Perspective. In *Irrational Exuberance*, pages 1–10.
- For more background on this topic, refer to an introductory or intermediate finance textbook such as Madura (2018).

Topic 4: Prospect Theory, Framing & Mental Accounting

References:

- Ackert and Deaves (2010), Chapter 3.
- Hambrick, D. Z. and Burgoyne, A. P. (2016). The Difference Between Rationality and Intelligence.
- The Economist (2013). Prospect theory and economics. *The Economist*.
- Freakonomics Podcast: The Men Who Started a Thinking Revolution.
- Experiment Article 5.

  Optional Reading:
- Barberis, N. (2013). Thirty Years of Prospect Theory in Economics: A Review and Assessment. *Journal of Economic Perspectives*, 27(1):173–196.[JSTOR]
- Kahneman, D. (2003). A Psychological Perspective on Economics. *The American Economic Review*, 93(2):162–168. [JSTOR]

Topic 5: Heuristics & Biases

References:

- Ackert and Deaves (2010), Chapters 5 & 8.
- Tversky, A. and Kahneman, D. (1974). Judgment under Uncertainty: Heuristics and Biases. *Science*, 185(4157):1124–1131. [JSTOR]
- Chen, D. L., Moskowitz, T. J., and Shue, K. (2016). Decision Making Under the Gambler's Fallacy: Evidence from Asylum Judges, Loan Officers, and Baseball Umpires. *The Quarterly Journal of Economics*, 131(3):1181–1242. [Link]
- Freakonomics Podcast: How to Make a Bad Decision
- Experiment Articles 6 & 7.

Optional Reading:

- Bae, K. H., Stulz, R. M., and Tan, H. (2008). Do local analysts know more? A cross-country study of the performance of local analysts and. *Journal of Financial Economics*, 88(April):581–606 [Link].
- Northcraft, G. B. and Neale, M. A. (1987). Experts, amateurs, and real estate: An anchoring-and-adjustment perspective on property pricing decisions. *Organizational Behavior and Human Decision Processes*, 39(1):84–97.

Topic 6: Overconfidence

References:

- Ackert and Deaves (2010), Chapters 6 & 9.
- The Economist (2012). Sometimes it helps if investors are gloomy. *The Economist*.
- The Economist (2017). When investors get stuck in the past. *The Economist*.
- Barber, B. M. and Odean, T. (2000). Trading Is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors. *The Journal of Finance*, 55(2):773–806. [JSTOR]

Optional Reading:

- Choi, N., Fedenia, M., Skiba, H., and Sokolyk, T. (2017). Portfolio concentration and performance of institutional investors worldwide. *Journal of Financial Economics*, 123(1):189–208. [Link]
- Grinblatt, M. and Keloharju, M. (2009). Sensation Seeking, Overconfidence, and Trading Activity. *The Journal of Finance*, 64(2):549–578. [Link] [JSTOR]
- Glaser, M. and Weber, M. (2007). Overconfidence and Trading Volume. *SSRN Electronic Journal*. [SSRN]
- Deaves, R., Lüders, E., and Luo, G. Y. (2009). An Experimental Test of the Impact of Overconfidence and Gender on Trading Activity. *Review of Finance*, 13:555–575.
- Goetzmann, W. N. and Kumar, A. (2008). Equity Portfolio Diversification. *Review of Finance*, 12(3):433–463.
- Jegadeesh, N. and Kim, W. (2006). Value of analyst recommendations: International evidence. *Journal of Financial Markets*, 9(3):274–309. [Link]

Topic 7: Emotion

References:

- Ackert and Deaves (2010), Chapters 7 & 10.
- Ackert, L. F., Church, B. K., and Deaves, R. (2003). Emotion and Financial Markets. *Federal Reserve Bank of Atlanta Economic Review*, 88(2):33. [FRBAtlanta]
- The Economist (2009b). Gutted instinct: A new device to prevent irrational online trades. *The Economist*.
- Zweig, J. (2010). Time to Take Stock of the Recent Market Rallies.
- Experiment Article 8.

  Optional Reading:
- Hirshleifer, D. and Shumway, T. (2003). Good Day Sunshine: Stock Returns and the Weather. *The Journal of Finance*, 58(3):1009–1032.[JSTOR]

Topic 8: Social Forces, Fairness, Altruism & Trust

References:

- Ackert and Deaves (2010), Chapter 9.
- Thaler, R. H. (2015). *Misbehaving: The Making of Behavioral Economics*. W.W. Norton, Chapters 14 & 15.
- Freakonomics Podcast: How to Hate Taxes Less.
- Experiment Articles 9 & 10.

Topic 9: Behavioural Explanations for Market Anomalies

References:

- Ackert and Deaves (2010), Chapters 13 & 14.
- Shiller, R. J. (1984). Stock prices and social dynamics. *Brookings Papers on Economic Activity*, 2(1):457–498. [Brookings]
- Shefrin, H. and Statman, M. (1985). The Disposition to Sell Winners Too Early and Ride Losers Too Long: Theory and Evidence. *The Journal of Finance*, 40(3):777. [JSTOR]
- Video: Fama and Thaler - Are Markets Efficient?.
- Experiment Articles 11 & 12.

Topic 10: Behavioural Finance and Retirement Savings

References:

- Ackert and Deaves (2010), Chapters 17 & 18.
- Thaler, R. H. and Sunstein, C. R. (2008). *Nudge: Improving Decisions About Health, Wealth and Happiness*. Yale University Press, Chapter 6.
- Deaves, R. (2005). Unravelling a Knotty Problem. *Canadian Journal of Investment*, (Spring):6–15. [Link]
- Dubner, S. J. (2012). On Not Following Your Own Advice - Freakonomics. [Freakonomics]

Optional Reading:

- Benartzi, S. and Thaler, R. H. (2004). Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving. *Journal of Political Economy,*, 112(1):S164–S187. [JSTOR]
- Madrian, B. C. and Shea, D. F. (2001). The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior. *The Quarterly Journal of Economics*, 116(4):1149–1187. [JSTOR]

Further topics if time permits:

- **Behavioural Investing**
  - Ackert and Deaves (2010), Chapter 19.
- **Neurofinance**
  - Ackert and Deaves (2010), Chapter 20.
  - The Economist (2011). Bad trade? Blame the adrenal cortex. *The Economist*.
- **Behavioural Corporate Finance & Governance**
  - Ackert and Deaves (2010), Chapters 15 & 16.
- **Behavioural Economics/Finance, Regulation and Policy Nudges**
  - Freakonomics podcast: Big Returns to Thinking Small.
  - Freakonomics Podcast: The Whitehouse Gets Into the Nudge Business.
  - Podcast: The Economist Asks Richard Thaler.
  - Tasic, S. (2011). Are Regulators Rational? *Journal des Economistes et des Etudes Humaines*, 17(1):1–19. [SSRN]
  - Sunstein, C. R. (2016). Do People Like Nudges? *Administrative Law Review*, 68(2):177–232. [JSTOR]

Note:

- The topics and schedule may be adjusted during the course.
- Links to articles related to the experiments conducted during lectures will be provided on AIMS.
- Additional readings may be assigned in lectures.

Schedule: An approximate and tentative course schedule is shown on the next page. This will be revised to accommodate our pace as we progress through the course. Exam dates will be confirmed in advance.

Week	Monday		Wednesday	
1	7 Sept.	(1) Course Introduction **(Zoom)**	9 Sept.	(1) Course Introduction **(Zoom)**
2	14 Sept.	(2) Preliminaries – Expected Utility **(Zoom)**	16 Sept.	(2) Preliminaries – Expected Utility **(Zoom)**
3	21 Sept.	(3) Preliminaries – Asset pricing, Efficiency, Agency **(Zoom)**	23 Sept.	(3) Preliminaries – Asset pricing, Efficiency, Agency **(Zoom)**
4	28 Sept.	(3) Preliminaries – Asset pricing, Efficiency, Agency **(Zoom)**	30 Sept.	(3) Preliminaries – Asset pricing, Efficiency, Agency **(Zoom)**
5	5 Oct.	(3) Preliminaries – Asset pricing, Efficiency, Agency **(Zoom)** **Presentation Proposal Due**	7 Oct.	(4) Prospect Theory **(Zoom)**
6	12 Oct.	*Holiday*	14 Oct.	**Exam 1** – Topics (1) to (3) **(Zoom)**
7	19 Oct.	(4) Prospect Theory **(Zoom)**	21 Oct.	(4) Framing & Mental Accounting **(Zoom)**
8	26 Oct.	(4) Framing & Mental Accounting **(Zoom)**	28 Oct.	(5) Heuristics & Biases **(Zoom)**
9	2 Nov.	(5) Heuristics & Biases **(Zoom)**	4 Nov.	(5) Heuristics & Biases **(Zoom)**
10	9 Nov.	(5) Heuristics & Biases **(Zoom)** (6) Overconfidence	11 Nov.	(6) Overconfidence **(Zoom)**
11	16 Nov.	(6) Overconfidence **(Zoom)**	18 Nov.	(7) Emotion **(Zoom)**
12	23 Nov.	**Exam 2** – Topics (4) to (6) **(Zoom)**	25 Nov.	(7) Emotion **(Zoom)** Presentation 1
13	30 Nov.	(7) Emotion **(Zoom)** Presentations 2 & 3	2 Dec.	(7) Emotion **(Zoom)** Presentation 4
14	7 Dec.	(8) Social Forces, Altruism, & Trust **(Zoom)** Presentation 5	9 Dec.	(8) Social Forces, Altruism, & Trust **(Zoom)** Presentations 6, 7 & 8
15	14 Dec.	(8) Social Forces, Altruism, & Trust **(Zoom)** Presentation 9; Darts Experiment	16 Dec.	Wrap-up Session, Exam 2 Review **(Zoom)**
16	21 Dec.	**Exam 3** – Topics (7) to (8), Darts Exp, Presentations **(Zoom)** Note that these topics link to earlier topics in the course.	–	–

Updated: 9 December 2020