

## **Behavioral and Experimental Finance**

**New York University, Stern School of Business**

**Professor Orly Sade**

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There is a growing strand of research suggesting that the standard economic paradigm: rational investors in an efficient market – does not adequately describe behavior in financial markets. In this course, we will explore part of this literature.

The basic premise of Experimental Economics is that economic and financial theories can be tested in a controlled laboratory setting. In this course you will participate in experiments that will illustrate some of the insights and findings of behavioral finance.

### 1 Practical Issues

#### *Time:*

The class meets once a week, for a total of 3 meetings. Each meeting time is divided into 4 sessions:

- Sessions 1 and 2 : 9:00 – 12:00
- Sessions 3 and 4: 13:00 – 16:00

#### *Blackboard:*

Announcements, readings, notes, problem sets and the solutions will be posted on my blackboard course page throughout the course so please check it regularly.

#### *Teaching Assistants:*

Jason Levine (PhD candidate)

Email: [jlevine@stern.nyu.edu](mailto:jlevine@stern.nyu.edu)

Office: 212-998-0314

Mobile: 203-482-2188

*There will be "virtual office hours" with the TA each T and TH from 9:30 P.M to 10:30 P.M*

#### *Office Hours:*

I will be available immediately after class for questions. You are welcome to set up an appointment with me by email to discuss the course material or the final project.

#### *Classroom:*

Your behavior should respect your classmates' desire to learn. Each lecture will begin exactly on time. Try not to come late. If you carry a cell phone, turn it off before entering class.

## 2 Grading and Studying

### *Grading:*

*Grades will be based on the final exam (40%), final project (45%) and problem sets (15%)*

### *Problem Sets:*

There will be 2 problem sets. You will be rewarded full credit on a problem set if you have made a good-faith effort to answer all of the questions, and if you hand in your answers on time. Late problem sets will not be accepted. Although you are encouraged to work in groups on the problem sets, you must hand in your own answers. You will receive the highest score for the problem sets if you receive credit for one problem set out of two (in other words, you are allowed to miss one problem set).

### *Exam:*

The course has a final exam. You will be allowed one double-sided page of notes for the final exam. Neither laptops nor palm pilots are allowed on the exam. To prepare for the exam, you should review the key issues discussed in class, in the readings and in the handouts and review the problem sets you handed in..

### *Final Project:*

The course has a final project that can be submitted in groups of up to 4 students. You will be given one week after the end of the course to complete the project. In other words, the project must be submitted electronically by August 2, 11:59 p.m. via e-mail to the TA of the course (cc me as well). Once we receive your project, you will receive an e-mail confirmation from us. The final project description is posted on Blackboard

### *Code of Conduct:*

You are responsible for maintaining Stern's code of conduct which mandates zero tolerance for cheating and plagiarism. Violations of the code of conduct will be prosecuted with a minimum penalty of failure for the course, as required by the code of conduct rules. If you become aware of any violations of the code of conduct you must take whatever steps are necessary to stop the violators.

### *Experiments:*

Active participation in the experiments is an integral part of the course.

## 3 Textbooks and Readings

There will not be a required textbook for this course, yet there will be suggested books that will complement the class material.

- 1) The Winner's Curse** by Richard Thaler, Princeton University Press
- 2) The Wisdom of the Crowds** by James Surowiecki, Anchor

I will supply the class with additional academic papers that will supplement the class presentations. I will also supply the class with additional articles from the business popular press. Because of the experimental nature of the course, some reading is required before class, while some reading is required only after class.

Tentative Time Line:

**RB = Required reading BEFORE class**

**RA= Required reading AFTER class**

**SB = Suggested reading BEFORE class**

**SA = Suggested reading AFTER class**

**PS = problem set (Listed on due date.)**

The articles and reading are listed in detail below the table according to the topic of the class

In the table, the articles are referred to by the last name of the authors. For Example BT refers to the article by Barberis and Thaler

A copy of the required reading articles will be supplied and a copy of all articles will be available via " blackboard"

Date	Topic	Required and Suggested Readings	Problems / Experiments
July 12 -A-	<i>Overview of the course Efficient markets? Why should you care?</i>	<b>RA</b> – article –BT (introduction pg 2-5, 10-11)	
July 12 -B-	<i>Prediction markets – introduction</i>	<b>SA</b> – Book: Wisdom of the Crowds Book: Winner Curse chapter 10 <b>RA</b> - article – WZ	
July 12 -C-	<i>Investors Rationality? -Biases</i>	<b>RA</b> - article BT – Chapter 3 Psychology (pg 11-15) <b>SA</b> - Book: Winner Curse chapters: 2,3,6,7,8,9 <b>SA</b> - article H, FP	
July 12 -D-	<i>Investors Rationality? -Biases</i>	<b>RA</b> - article BT – Chapter 3 Psychology (pg 11-15) <b>SA</b> - Book: Winner Curse chapters: 2,3,6,7,8,9 <b>SA</b> - article H, FP	Getting to Know You

July 19 -A-	<i>Auction, winner curse + private value</i>	<b>SA</b> – Book: Winner Curse, chapter 5	<b>PS1</b>
July 19 -B-	<i>Financial Auctions</i>	<b>RB</b> - Experiment Instructions <b>SA</b> – article SSZ	
July 19 -C-	<i>Guest Lecture: Whitney J. White Managing Director, ECM / Chief Technology Officer and Jim Donohue Sr Investment Banker WR Hambrecht + Co</i>		
July 19 -D-	<i>Experimental Finance- Challenges and advantages  Evidence that challenge EMH</i>	<b>SA</b> – article BT pages 33-35, JT	
July 26 -A-	<i>Evidence that challenge EMH + Limits of Arbitrage</i>	<b>SB</b> – article JNT	<b>PS2</b>
July 26 -B-	<i>Evidence that challenge EMH + Limits of Arbitrage</i>		
July 26 -C-	<i>Guest Lecture: Ted Dimig Head of client portfolio manager team – Interpid Product - JP Morgan</i>	<b>SB</b> – HBS case	
July 26 D-	- Final Exam-		

Readings:

**July 12:**

Introduction:

Nicholas Barberis and Richard Thaler, "A Survey of behavioral Finance" 2002, Handbook of the economics of finance

Prediction Markets Introduction:

Justin Wolfers and Eric Zitzewitz (2004), Prediction Markets, *Journal of Economic Perspectives—Volume 18, Number 2—Spring 2004—Pages 107–126*

Biases:

French, Kenneth R., and James M. Poterba, "Investor Diversification and International Equity Markets," *American Economic Review*, Vol. 81, No. 2 (May 1991): 222-226.

Huberman, Gur, "Familiarity Breeds Investment," *Review of Financial Studies*, Vol. 14, No. 3 (Fall 2001): 659-680.

**July 19:**

Discussion of experimental results:

Sade Orly, Charles Schnitzlein and Jaime Zender "Competition and Cooperation in Divisible Good Auctions: An Experimental Examination" (2006) - *Review of Financial Studies* Volume 19 (1), January 2006, 195-235

Evidence that Challenges the EMH

Jegadeesh, Narasimhan and Titman, Sheridan , "Momentum" (October 23, 2001). University Of Illinois Working Paper

**July 26:**

Evidence that Challenges the EMH

Jegadeesh, Narasimhan and Titman, Sheridan , "Momentum" (October 23, 2001). University Of Illinois Working Paper

Behavioral Finance at JP Morgan:

Malcolm Baker and Aldo Sesia, Behavioral Finance at JPMorgan

