New York University
Stern School of Business

FINC-UB 29   Tony Marciano
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                                                       KMC 9-87

Course Syllabus

I. Course Materials

A.   Required:
     Richard Thaler, *Advances in Behavioral Finance Vol. 2,* Princeton University Press (RT).
       Focused more on finance with academic bent.

     Daniel Kahneman, *Thinking Fast and Slow*, Farrar, Straus and Giroux. (DK)
       Psychologist's perspective with easy-reading bent.

     Other Books of Note:
     Hersh Shefrin, *Behavioral Corporate Finance*, McGraw-Hill. Popular text with special
     emphasis on Corporate Finance rather than Investment issues.

     George Akerlof and Robert Shiller, *Animal Spirits*, Princeton University Press. Popular,
     inexpensive book that is a light read on markets.

     Cass Sunstein and Richard Thaler, *Nudge*, Yale University Press. Popular book on
     applying Behavioral Finance to real-life situations (Choice Architecture).

     This list represents the biggest names in the field as well. But this field, unfortunately,
     does not yet have a good textbook that captures all the behavioral findings with their
     associated applications to finance. There are good websites that list many of the
     behavioral findings and anomalies (http://www.behaviouralfinance.net or even Wikipedia).
      But of course, doing it this way, while illuminating, provides no coherence to the topic
     whatsoever – that is, you will find this to be an interesting laundry list of issues that are
     useful but hard to synthesize.

 B. Digital Coursepack:
     1. Syllabus
     2. Articles
     3. Case

 C. Items to be handed out in class
     1. Lecture Notes
     2. Homework Problems & Answers

II. Course Description

The field of Finance has traditionally made assumptions of human rationality in decision making in order to facilitate modeling. It has been a great success that has developed powerful Nobel prize-winning theories that are quite consistent with observation – contributions such as portfolio theory, option-pricing, valuation, agency and signaling among others. These contributions have gone on to revolutionize the practice of both investment and corporate finance. However, there remain many anomalies that these traditional models struggle to explain; such as, various anomalies in the price of assets (e.g., why low P/E firms outperform the high ones), the wide swings in stock prices – say relative to the more stable dividends shareholders receive, and why managers attempt to keep earnings stable through Earnings Per Share (EPS) manipulation. The field of Behavioral Finance has put forth explanations for these anomalies and others by relaxing the assumption of the perfectly rational human. In this course, I define the traditional finance's decision-maker as having three traits: (1) he is only interested in maximizing his own welfare; (2) his models for determining his utility as a function of his actions follow perfect mathematical logic; and (3) the cool, calm and collected decision-maker takes actions without emotional bias. We will find that there are substantial violations of each of these. Thus, humans being aware of them can help themselves in their everyday life as well as in finance, and that they might shed light on some of the anomalies that Traditional Finance have had a hard time explaining.

Note that given the wide range of applicability of these psychological findings, this course is not limited to applications to investments and corporate finance but rather will also include other business implications. That said, we will highlight the implications of behavioral economics regarding the efficient market hypothesis (EMH), investment strategies and performance, and various corporate finance decisions such as acquisitions, IPO's, capital structure, etc.

II. Course Schedule

We will cover these three items in the following order as described in the schedule below. First, we will examine a number of systematic biases that humans commonly suffer from psychologically – things such as regret and loss. Second, we will highlight the common cognitive errors humans make in their calculations and list some of their implications. Third, we will determine the impact that social concerns have on an individual's financial decision-making. The former is probably the most subtle and thus possibly most important. In each case, we will highlight the psychological finding and then describe its implications a field such as finance.

Class	Lecture Topic	Reading
Jan 23	Introduction: Psychology and Finance	RT 1, "Rethinking…"
Jan 25	EMH: Implications and Limitations	"NoiseTrader",Shiller
Jan 30	Anomalies: Cross-sectional	"Acrual","Disectng", RT8-10
Feb 1	Anomalies: Arbitrage, Macro	RT 4-6
Feb 6	CANCELLED CLASS	
Feb 8	JP MORGAN CASE	
Feb 13	Institutional Finance & Applications	RT 8, 2,11
Feb 15	Managers in an Inefficient Mkt	RT 17, 18
Feb 22,27	Emotional Bias: Prospect Theory	"Prospect Theory"
		RT 7,12; DK Part IV.
Feb 29, Mar 5	Other Emotional Biases and Implications	RT 13-14, DK Part III
	Hyperbolic discounting, Effects in the field	"Self-Control","Odysseus"
Mar 7,19	Cognitive Error: Anchoring, Heuristics…	DK Parts I and II.
		RT3, "Contextual"
Mar 21	Review Session	
Mar 26	MIDTERM	
Mar 28	Social: Trust/Social Capital, Culture/Religion	"Role of Social…",
		"Learning behavior others"
Apr 2,4	Project Meetings Week/Open	
Apr 9,11	Investor and Manager Behavior	RT 15,16,19
Apr 16,18,23	Project Presentations/Open-Summary	
Apr 25,30	Extensions & Neuroeconomics	"Neuroeconomics"
May 2	Course Summary	
May 7	Review Session	
	In-Class Final Exam	

Note: The Undergrad section meets 27 times (1 cancelled) and the MBA class 26.

III. Grading
Total Grade = Max {70% Exams+10% Homeworks, 80% Exams} + 20% Project
Homework Score: out of 10 pts (see below)
Exam Score = Max{100% Final, 55% Final+45% Midterm}
Superior class participation will earn you bonus points. Distracting class participation will be "rewarded" with cold calling or a reduction in previously earned bonus points.

Hand in 4 of the 5 homeworks for 2.5 points each. Do all 5 or excellent work on 4 gets bonus points to determine borderline cases. Note JPMorgan case counts as one homework.
Homework grading follows the following format: A good job earns 2.5 pts (check +); a relatively weak effort earns 1 pt (check); garbage and late entries count 0.
HOMEWORKS AND PROJECT CAN BE DONE IN GROUPS AS LARGE AS THREE.

Project will be group assignment on Behavioral Finance topic with short presentation in class.