BEHAVIORAL FINANCE

Learning Objective: The objective of this paper is to introduce the students to the role of human behavior in financial decision making. This will enable them to understand some psychological biases which lead to various anomalies.
The latest published research papers will be used for teaching to a greater extent.

Course Contents:

Unit 1 **ectures: 10** **L**

Introduction to Behavioural Finance-Overview, History of Behavioral Finance; From standard finance to behavioral finance- Are financial markets efficient?, Limits to arbitrage-Fundamental Risk, Noise Trader Risk, Implementation cost, evidence of limits to arbitrage

Unit II **ectures: 12** **L**

Cognitive biases, beliefs and heuristics-Preferences: Prospect Theory, Ambiguity aversion, Loss aversion, Framing, Non-consequentialism: Disjunction Effect, Self-deception, Neurofinance (introduction only); Mental Accounting, Self-control, Regret avoidance and Cognitive dissonance, Representativeness and Availability, Anchoring and Belief perseverance, Overconfidence, Optimism and wishful thinking, Overreaction and Conservatism, Self attribution, Recency bias

Unit III **Lectures: 10**

Endowment effect, Disposition effect, reference price effect, Herd Behavior, hindsight, winners' curse, cognitive dissonance, familiarity bias, status quo bias, law of small numbers, information overload

Unit IV **ectures: 14** **L**

Application-The Aggregate Stock Market: Equity Premium Puzzle-prospect theory, loss aversion; The Volatility Puzzle-beliefs, preferences; The Cross Section of Average returns-size premium, long term reversals, predictive power of scaled price ratios, momentum, event studies

Unit V **ectures: 10** **L**

Application-The closed end funds and co movement: investor behavior (saving and investment)-insufficient diversification, naïve diversification, excessive trading, the selling decision, the buying decision
Application-Corporate Finance: Security Issuance, Capital structure and Investment, Dividends, Managerial Irrationality,

Text Books:

1. Kahneman, Daniel & Tversky, Amos. (2000). *Choices, Values and Frames.* Cambridge University Press
2. Shleifer, Andrei.Inefficient Markets-*An Introduction to Behavioral Finance*. Oxford University Press

References:

1. Thaler, Richard & Barberis, Nicholas. (2002) *A Survey of Behavioral Finance*, http://dx.doi.org/10.2139/ssrn.327880