

Instructor: Stephan Siegel
Office: PCAR 430
Phone: +1 (206) 543 0784
Email: ss1110@uw.edu
Web: <http://faculty.washington.edu/ss1110/>

Office Hours: By appointment
Day and Time: MW 8:30 am – 10:20 am
Class Room: PCAR 394
Course Web Site: Canvas

Teaching Assistant: Quentin Dupont, dupontq@uw.edu

Course Description

In many ways, “behavioral finance” is a tautology. All finance and economics deal with human behavior, the interactions of such behavior, and the resulting allocation of resources, typically through a market mechanism. However, since “traditional” finance assumes wealth-maximizing and fully rational behavior, “behavioral finance” specifically studies (seemingly) non-optimal and irrational behavior, in particular, of investors and executives.

In this new finance elective, we will document the behavior of investors, relate it to biases and fallacies known from psychology, and inquire about its origins. We will then think about whether and how “mistakes” by individual investors could affect prices in financial markets. It is here where the debate between “traditional” economists, such as Gene Fama, and “behavioral” economists, such as Bob Shiller and Dick Thaler, is taking place. While we will not resolve this debate, we will think about the opportunities and challenges it presents for “sophisticated” market participants, such as hedge funds.

Finally, we will explore the implications of behavioral finance for corporate executives. On the one hand, they have to account for the “irrational” behavior of their investors. On the other hand, they might suffer from making imperfect decisions themselves.

Since this is a new course, the material and the teaching approach have not been fully tested yet. On the upside, students’ feedback can shape the course throughout the quarter. On the downside, certain cases or ideas might not work quite as well as expected.

Course Objective

The course aims at complementing “traditional” finance with empirical evidence and concepts from the new field of “behavioral” finance, which itself builds on psychology and sociology as well as neuroscience and behavioral genetics. By integrating approaches and ideas from different disciplines and trying to achieve consilience between them, students’ ability to understand and predict economic behavior and market outcomes should improve.

While the most immediate applications of behavioral finance are with respect to formulating investment strategies, many corporate financial decisions are affected as well. More broadly, many of the challenges individuals face when making financial decisions could likely be addressed by big data and technology.

Course Format and Material

The course combines lectures with several business cases and in-depth exploration of the latest research in behavioral finance and economics.

The following course material is required or recommended

- **Required: Course Pack (CP)**
The course pack will be available at the University Bookstore. It contains all five cases used in this course.
- **Required Access: Canvas**
I will post additional reading material on Canvas. I will also post my lecture notes and case-relevant material on Canvas.
- **Recommended Textbook: Ackert and Deaves: Behavioral Finance, 2010.**
Ackert and Deaves will be available at University Bookstore. It offers a fairly comprehensive discussion of behavioral finance. I have assigned chapters from the book throughout the course.

There are many other great books that cover aspects of the course. In particular:

- Kahneman (2013): Thinking, Fast and Slow
- Thaler and Sunstein (2009): Nudge: Improving Decisions About Health, Wealth, and Happiness
- Robert Shiller (2016): Irrational Exuberance
- Andrew Lo (2017): Adaptive Markets: Financial Evolution at the Speed of Thought

Requirements

I expect that you come prepared to each class. To do so, you should read the assigned chapters from the textbook and review the additional reading material on Canvas.

We will discuss five business cases. It is crucial that you prepare all of them. To help you with the preparation, I will provide a number of questions for each case. At the beginning of class, you should be in a position to describe the set-up of the case, the main questions at hand, the possible solutions, and the reasons why you favor one solution over another. If you are not sufficiently prepared, you should alert me before class, as I will call on individual students during case discussions.

For three of the five cases (see “due” in the class outline below), you will have to also hand in a case write-up at the beginning of the class, in which the case will be discussed. Write-ups are prepared by students working in groups of up to three students. Write-ups should be no more than four pages of double-spaced text, with no more than four pages of charts or tables. The grade of each write-up will depend on the quality of the analysis and the effectiveness with which you present your argument. I will provide specific questions for each case write-up that I ask you to address.

To familiarize you with the latest research in behavioral finance, each student will have to give a brief (5-10 minutes, depending on final class size), individually prepared

presentation of a recent research paper. I will propose a number of papers and students will sign up at the beginning of the quarter.

Instead of a final exam, each student (in groups of up to three) will have to write a short paper (up to 5 pages of double-spaced text, up to 5 pages of appendix, 1 page of references) on a behavioral finance topic. Topics consists of empirical work around anomaly-based investment strategies, possibly conducting experiments, as well as additional business cases. We will discuss the possible topics at the beginning of the quarter. Each team will present their findings during the last two classes. The paper will be due in class on March 13, 2019.

For all write-ups and presentations, please remember that even though form without substance is meaningless, form still matters. You should prepare all graded material for this course in a form that meets professional standards: This includes dating any material, numbering pages, labeling graphs and tables, referencing sources, and, most importantly, expressing yourself in a concise manner.

Class participation is an important part of this course. You can obtain participation credit in several ways; for example, by asking and answering questions during lecture classes, by presenting your solution to a case study, or by contributing to the discussion forum on Canvas. I ask you to keep track of your participation using the self-evaluation form that I will collect from you at the end of the quarter to complement my own notes on your participation.

Grading

Grades will be based on the following requirements:

Class participation (individual):	25.0%
Case write-ups (group):	30.0%
Research paper presentation (individual):	15.0%
Short paper (group):	30.0%

The target median grade for this course is in the range of 3.4 to 3.6.

Academic Integrity

Academic integrity is essential to research and teaching at the University of Washington. Out of respect and fairness to everyone, I will not accept any violation of academic integrity, including cheating, attempted cheating, plagiarism, or lying. Submissions must reflect your own ideas and words; all contributions of others must be attributed properly. It is explicitly forbidden to seek or use existing solutions to any of the assignments in this class.

Feedback

It is important to me to know about any concerns or questions you might have. I also appreciate any comments on the course, in particular about lectures or cases that you find particularly helpful or not helpful at all. Please feel free to stop by my office or send me an email if you would like to talk to me.

Course Outline

The course outline is subject to change depending on actual progress. As necessary, I will post updated course outlines on Canvas.

Class	Date	Day	Topic
1	7-Jan	Mon	Course Overview and Introduction Read Syllabus Ackert and Deaves: Chapter 1 Review Hirshleifer (2015): Behavioral Finance
BEHAVIOR			
2	9-Jan	Wed	Preferences Read Ackert and Deaves: Chapters 3 and 11 Review Della Vigna (2009): Psychology and Economics: Evidence from the Field (for Classes 2-4)
3	14-Jan	Mon	Beliefs and Expectations Read Ackert and Deaves: Chapters 5 and 6
4	16-Jan	Wed	Decision Making Read Ackert and Deaves: Chapters 5 and 6
5	21-Jan	Mon	No Class: Martin Luther King Jr. Day
6	23-Jan	Wed	Origins of Behavior Read Ackert and Deaves: Chapter 20 Review Camerer (2013): Goals, Methods, and Progress in Neuroeconomics Beauchamp et al. (2011): Molecular Genetics and Economics
INVESTORS			
7	28-Jan	Mon	Saving for Retirement <u>Due</u> CP: Case: Dimensional Fund Advisors (DFA)'s Entry into the Retirement Market Review Ackert and Deaves: Chapter 17 Benartzi and Thaler (2007): Heuristics and Biases in Retirement Savings Behavior
8	30-Jan	Wed	Behavior of (Individual) Investors Read Ackert and Deaves: Chapters 8-10 Review Barber and Odean (2013): The Behavior of Individual Investors
9	4-Feb	Mon	Behavior of (Individual) Investors (continued) Prepare CP: Case: Behavioral Finance at JP Morgan

MARKETS

- 10 6-Feb Wed **Efficient Market Hypothesis**
Read Ackert and Deaves: Chapters 2 and 13
Review Shleifer (2000): Inefficient Markets: An Introduction to Behavioral Finance, Chapter 1
- 11 11-Feb Mon **Arbitrage**
Due CP: Case: Strategic Capital Management, LLC (A)
- 12 13-Feb Wed **Behavioral Asset Pricing**
Read Ackert and Deaves: Chapters 2 and 13
Review Lamont and Thaler (2003): Anomalies
Fama (1998): Market efficiency, long-term returns, and behavioral finance
- 13 18-Feb Mon **No Class: President's Day**
- 14 20-Feb Wed **Momentum**
Due CP: Case: AQR Momentum funds
- 15 25-Feb Mon **Behavioral Asset Pricing (continued)**
Read Ackert and Deaves: Chapter 14
Review Shiller (2003): From Efficient Markets Theory to Behavioral Finance

FIRMS

- 16 27-Feb Wed **Catering to Investors**
Prepare CP: Case: Wells Fargo Convertible Bonds
- 17 4-Mar Mon **Rational and Irrational Managers**
Read Ackert and Deaves: Chapters 15 and 16
Review Baker and Wurgler (2013): Behavioral Corporate Finance: An Updated Survey

EXTENSIONS: LITERACY, POLICY, TECHNOLOGY

- 18 6-Mar Wed TBD
- 19 11-Mar Mon **Student Presentations**
- 20 13-Mar Wed **Student Presentations**