



## Behavioral and Experimental Finance – summer 2012

**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:*

TBA

*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 (50%) and problem sets (10%)*

*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. Neither laptops nor other electronic devices 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 July 22, 11:59 p.m. via e-mail to me: [osade@stern.nyu.edu](mailto:osade@stern.nyu.edu) (cc the TA of the course 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. The business articles are referred to by their number in the reading list. For example "1" refers to the "economist" article from July 16 2009. A copy of the required reading articles will be supplied and a copy of all articles will be available via " blackboard"

<b>Date</b>	<b>Topic</b>	<b>Required and Suggested Readings</b>	<b>Problems / Experiments</b>
July 1 -A-	<i>Overview of the course Efficient markets? Why should you care?</i>	<b>RA</b> – article "1" <b>SA</b> - article –BT (introduction pg 2-5, 10-11) and article "3"	
July 1 -B-	<i>Prediction markets – introduction</i>	<b>SA</b> – Book: Wisdom of the Crowds Book: Winner Curse chapter 10 articles "5" "6" and "7" <b>RA</b> - article – WZ	
July 1 -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 "8" and "9"	
July 1 -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 "8" and "9"	Getting to Know You

July 8 -A-	<i>Guest: Daniel P Egan, Head of Behavioural Finance, Americas, Barclays</i>		<b>PS1</b>
July 8 -B-	<i>Biases Auctions and biases</i>	<b>SA</b> – Book: Winner Curse, chapter 5	
July 8 -C-	<i>Financial Auctions Experimental Finance- Challenges and advantages</i>	<b>RB-</b> Experiment Instructions <b>SA</b> – article SSZ	
July 8 -D-	<i>Evidence that challenge EMH + Guest: Robert Whitelaw (PhD), the Chair of the Finance Department at Stern, NYU "Maxing Out: Stocks as Lotteries and the Cross-Section of Expected Returns</i>	<b>SA</b> – article BT pages 33-35, JT	
July 15 -A-	<i>Evidence that challenge EMH</i>		<b>PS2</b>
July 15 -B-	<i>Evidence that challenge EMH + Limits of Arbitrage</i>	<b>SB</b> – article JT <b>SA</b> – article BCW	
July 15 -C-	<i>Guest: Christopher T. Blum, Managing Director, Global Head of Equities - JP Morgan</i>	<b>SB</b> "13"	
July 15 D-	- Final Exam-		

Readings:

**July 1:**

Introduction:

- (1) Efficiency and beyond, *The Economist*, Jul 16th 2009
- (2) Nicholas Barberis and Richard Thaler, "A Survey of behavioral Finance" 2002, *Handbook of the economics of finance*
- (3) The Intelligent Investor: Inefficient Markets Are Still Hard to Beat, By Jason Zweig *WSJ*, Jan 9, 2010

Prediction Markets Introduction:

- (4) Justin Wolfers and Eric Zitzewitz (2004), Prediction Markets, *Journal of Economic Perspectives—Volume 18, Number 2—Spring 2004—Pages 107–126*
- (5) Workers, Place Your Bets By Rachel King, *Businessweek*, Aug 3, 2006
- (6) A Guide to Prediction Markets: Tip Sheet, *Businessweek*
- (7) Hollywood Games People Play, By Rachael King, *Businessweek*, Aug 7, 2006

Biases:

- (8) So much for snap decisions By Diane Cole, *WSJ*, April 9 2012
- (9) Control Yourself, How psychological biases can make a mess of our financial decisions. Especially these days By VERONICA DAGHER, *WSJ*, June 8, 2009

**July 8:**

Discussion of experimental results:

- (10) 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

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

**July 15:**

Evidence that Challenges the EMH

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

Guests:

- (12) Turan Bali, Nusret Cakici and Ribert Whitelaw "Maxing Out: Stocks as Lotteries and the Cross-Section of Expected Returns", 2010, forthcoming *Journal of Financial Economics*
- (13) Making Money When the Market Is Mistaken, By CONRAD DE AENLLE, *The New York Times*, April 10, 2005

## GETTING TO KNOW YOU

- Name: \_\_\_\_\_
- What are your expectations from the class?
- What are your expectations from your career?