Module 5 – (ch13) Investor Behavior and Capital Market Efficiency

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Note: This summary will be delivered **in printed form only**. No PDF version is available.

Overview: This summary covers the key points from Ch. 13 of *Berk & DeMarzo*.

1) **Competition & Alphas**
   Prices continuously incorporate news; investors compare expected vs. required return (SML) □ *alpha* = gap. Competition tends to drive alphas toward zero.

2) **Information & Rational Expectations**
   Market efficiency requires correct interpretation of info on average. Market can look inefficient if many investors misread signals or care about non-mean/variance goals.

3) **Individual Investor Biases**
   Underdiversification (familiarity, relative wealth), overtrading (overconfidence, sensation seeking) → lower net performance after costs.

4) **Systematic Trading Biases**
   Disposition effect (sell winners, hold losers), attention/mood effects, herding. These can create temporary predictability exploited by sophisticated traders.

5) **Efficiency of the Market Portfolio**
   After fees, average mutual fund *net* alpha ≤ 0; scale/liquidity constraints erode skill advantages. Holding the market is hard to beat persistently.

6) **Style-Based Patterns**
   Size, value (HML), and momentum signals have earned positive historical alphas; may proxy for risks or behavioral mispricing.

7) **Multifactor Models**
   Beyond CAPM: APT and Fama–French–Carhart (MKT, SMB, HML, MOM). Expected return as exposures to multiple traded factor portfolios.

8) **Methods in Practice**
   Managers largely use CAPM/WACC, sometimes with factor overlays; evidence and behavior still broadly consistent with CAPM discipline.

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