

Harvard University  
January 27, 2014

**Behavioral Finance**  
**Econ 2728**  
Spring 2014  
Catalog Number: 8633

Andrei Shleifer

**Course Overview:**

This course provides an overview of recent theoretical and empirical work on asset pricing that adopts a “behavioral” perspective—i.e., that considers the joint consequences of: i) investors who have either less-than-fully rational beliefs or non-standard preferences; and ii) various impediments to arbitrage.

**Meeting time and location:**

Wednesdays 1:30 – 3:30 PM  
Science Center 110

**Instructor:**

Andrei Shleifer, Littauer M-9, [ashleifer@harvard.edu](mailto:ashleifer@harvard.edu), Ph. 5-5046  
Teaching Assistant: Vladimir Mukharlyamov, [mukharly@fas.harvard.edu](mailto:mukharly@fas.harvard.edu)  
Office hours: email [nbiefer@fas.harvard.edu](mailto:nbiefer@fas.harvard.edu) for an appointment.

**Course web site:**

<http://www.registrar.fas.harvard.edu/courses-exams/course-catalog/economics-2728-behavioral-finance>

Overview:

## Schedule

Jan 29	Lecture 1	Introduction
Feb 5	Lecture 2	Limited Arbitrage
Feb 12	Lecture 3	Value Investing
Feb 19	Lecture 4	Bubbles, Extrapolation, Positive Feedback
Feb 26	Lecture 5	Prospect Theory - <b>Nicholas Barberis (Guest)</b>
March 5	Lecture 6	Debt Markets – <b>Samuel Hanson (Guest)</b>
March 12	Lecture 7	Heterogeneous Beliefs – <b>Alp Simsek (Guest)</b>
March 19	No Lecture	Spring Break
March 26	Lecture 8	Introduction to the Financial Crisis
April 2	Lecture 9	Securitization – <b>Erik Stafford (Guest)</b>
April 9	Lecture 10	Investment – <b>Malcolm Baker (Guest)</b>
April 16	Lecture 11	Stereotypes – <b>Pedro Bordalo (Guest)</b>
April 23	Lecture 12	Flows
April 30	Lecture 13	Money Management and the Growth of Finance

---

## Requirements and grading:

The requirements for the course include six referee reports on shared papers, to be emailed to Vladimir by midnight, the day before class. In lieu of a final exam, there will be a take-home referee report.

## **Behavioral Finance Preliminary Reading List**

### **The textbook for the course:**

Andrei Shleifer (2000), “Inefficient Markets”, *Oxford University Press*.

All published papers are available on Hollis E – Journals or JSTOR unless noted. Those not available through the library will be on the course home page and/or in hardcopy.

### **Lecture 1 - Introduction, Jan 29**

Andrei Shleifer (2000), “Inefficient Markets”, *Oxford University Press*, Chapter 1 & 4.

Lamont, Owen and Richard Thaler (2003), “[Anomalies: The Law of One Price in Financial Markets](#),” *Journal of Economic Perspectives*, 17(4): 191-202.

Summers, Lawrence H. (1986), “[Does the Stock Market Rationally Reflect Fundamental Values?](#)”, *Journal of Finance*, 41(3): 591-601.

Black, Fischer (1986), “[Noise](#)”, *Journal of Finance*, 41(3): 529-543.

### **Lecture 2 - Limited Arbitrage - Feb 5**

Andrei Shleifer (2000), “Inefficient Markets”, *Oxford University Press*, Chapter 2 & 3.

Froot, Kenneth A. and Emil Dabora (1999), “[How Are Stock Prices Affected by the Location of Trade?](#)”, *Journal of Financial Economics*, 53: 189-216.

Ljungqvist, Alexander and Wenlan Qian (2014) “[How Constraining Are Limits to Arbitrage? Evidence from a Recent Financial Innovation](#)”, (Working Paper).

**(REFEREE REPORT #1 due)**

### **Lecture 3 – Value Investing – Feb 12**

Andrei Shleifer (2000), “Inefficient Markets”, *Oxford University Press*, Chapter 5.

Barberis, Nicholas, Andrei Shleifer and Robert Vishny (1998), “[A Model of Investor Sentiment](#)”, *Journal of Financial Economics* 49: 307-343.

Hong, Harrison and Jeremy C. Stein (1999), “[A Unified Theory of Underreaction, Momentum Trading and Overreaction in Asset Markets](#)”, *Journal of Finance* 54(6): 2143-2184.

Clifford S. Asness, Tobias J. Moskowitz, and Lasse Heje Pedersen (2013), “[Value and Momentum Everywhere](#)”, *Journal of Finance* 68(3): 929–985

### **Lecture 4 - Bubbles, Extrapolation, Positive Feedback - Feb 19**

Andrei Shleifer (2000), “Inefficient Markets”, *Oxford University Press*, Chapter 6.

Greenwood, Robin, and Andrei Shleifer (2014), “[Expectations of Returns and Expected Returns](#)”, *Review of Financial Studies* 1-33.

Nicholas Barberis, Robin Greenwood, Lawrence Jin, Andrei Shleifer, “[X-CAPM: An Extrapolative Capital Asset Pricing Model](#)”, (Working Paper).

Ing-Haw Cheng, Sahil Raina, and Wei Xiong (2013), “[Wall Street and the Housing Bubble](#)”. *American Economic Review*, forthcoming.

**(REFEREE REPORT #2 due)**

### **Lecture 5 - Prospect Theory - Nicholas Barberis (Guest) - Feb 26**

Nicholas Barberis, Ming Huang, Tano Santos (2001), "[Prospect Theory and Asset Prices](#)", *Quarterly Journal of Economics* 116: 1-53.

Nicholas Barberis, Ming Huang (2008), "[Stocks as Lotteries: The Implications of Probability Weighting for Security Prices](#)", *American Economic Review* 98(5): 2066-2100.

Nicholas Barberis (2012), "[A Model of Casino Gambling](#)", *Management Science* 58(1): 35-51 (Special Issue on Behavioral Economics).

Nicholas Barberis, Wei Xiong (2012), "[Realization Utility](#)", *Journal of Financial Economics* 104(2): 251-271.

### **Lecture 6 - Behavioral Debt – Samuel Hanson (Guest) - Mar 5**

Greenwood, Robin, and Dimitri Vayanos (2013). “[Bond Supply and Excess Bond Returns](#)”, *Review of Financial Studies*, forthcoming.

**(REFEREE REPORT #3 due)**

Greenwood, Robin, and Samuel G. Hanson (2013) “[Issuer Quality and Corporate Bond Returns](#).” *Review of Financial Studies*, 26 (6): 1483–1525.

Hanson, Samuel Gregory (2014) “[Mortgage Convexity](#)”, *Journal of Financial Economics*, forthcoming.

Krishnamurthy, Arvind and Annette Vissing-Jørgensen (2012), “[The Aggregate Demand for Treasury Debt](#)”, *Journal of Political Economy*, 120(2): 233-267.

Krishnamurthy, Arvind and Annette Vissing-Jørgensen (2011), “[The Effects of Quantitative Easing on Long-term Interest Rates](#)”, Brookings Papers on Economic Activity, Fall 2011.

### **Lecture 7 - Heterogeneous Beliefs – Alp Simsek (Guest) – Mar 12**

Harrison, J. Michael and David M. Kreps (1978), “[Speculative Investor Behavior in a Stock Market with Heterogeneous Expectations](#)”, *Quarterly Journal of Economics*, 92(2): 323-336.

Scheinkman, José A. and Wei Xiong (2003), “[Overconfidence and Speculative Bubbles](#)”, *Journal of Political Economy*, 111(6): 1183-1219.

Alp Simsek (2013), “[Belief Disagreements and Collateral Constraints](#)”, *Econometrica*, 81(1): 1-53.

Hong, Harrison and Jeremy C. Stein (2007), “[Disagreement and the Stock Market](#)”, *Journal of Economic Perspectives*, 21(2): 109–128.

### **Lecture 8 - Introduction to the Financial Crisis – Mar 26**

Gennaioli Nicola, Andrei Shleifer, and Robert W Vishny (2012), “[Neglected Risks, Financial Innovation and Financial Fragility](#)”, *Journal of Financial Economics* 104(3): 452-468.

Gennaioli Nicola, Andrei Shleifer and Robert W Vishny (2013), “[A Model of Shadow Banking](#)”, *Journal of Finance* 68(4): 1331-1363.

Stefan Nagel (2014), “[The Liquidity Premium of Near-Money Assets](#)”, (Working Paper).  
**(REFEREE REPORT #4 due)**

### **Lecture 9 – Securitization – Erik Stafford (Guest) - Apr 2**

Coval, Joshua D., Jakub W. Jurek, and Erik Stafford (2009), “[The Economics of Structured Finance](#)”, *Journal of Economic Perspectives*, 23(1): 3–25.

Coval, Joshua D., Jakub W. Jurek, and Erik Stafford (2009), “[Economic Catastrophe Bonds](#)”, *American Economic Review*, 99(3): 628-666.

Coval, Joshua, Kevin Pan, and Erik Stafford (2014), “[How Markets Learn](#)”, (Working Paper).  
**(REFEREE REPORT #5 due)**

### **Lecture 10 - Investment – Malcolm Baker (Guest) – Apr 9**

Stein, Jeremy (1996), “[Rational Capital Budgeting In An Irrational World](#)”, *The Journal of Business*, 69(4): 429–455.

Baker, Malcolm, Jeffrey Wurgler (2007), “[Investor Sentiment in the Stock Market](#)”, *Journal of Economic Perspectives*, 21(2): 129–151.

Baker, Malcolm (2009), “[Capital Market-Driven Corporate Finance](#)”, *Annual Review of Financial Economics* 1, no. 1: 181–205.

Baker, Malcolm, Xin Pan, and Jeffrey Wurgler (2012), “[The Effect of Reference Point Prices on Mergers and Acquisitions](#)”, *Journal of Financial Economics*, 106(1). 1: 49–71.

### **Lecture 11 – Stereotypes – Pedro Bordalo (Guest) – Apr 16**

Pedro Bordalo, Nicola Gennaioli, Andrei Shleifer (2013), “Stereotypes” (Working Paper).

### **Lecture 12 - Flows - April 23**

Barberis, Nicholas, and Andrei Shleifer (2003), “[Style Investing](#)”, *Journal of Financial Economics*, 68(2): 161-199.

Nicholas Barberis, Andrei Shleifer, Jeffrey Wurgler (2005), “[Comovement](#)”, *Journal of Financial Economics* 75: 283–317.

Andrea Frazzini, Owen A. Lamont (2008), “[Dumb money: Mutual fund flows and the cross-section of stock returns](#)”, *Journal of Financial Economics* 88: 299–322.

Dong Lou and Christopher Polk (2013), “[Comomentum: Inferring Arbitrage Activity from Return Correlations](#)”, (Working Paper).

**REFEREE REPORT #6 due**

### **Lecture 13 – Money Management and The Growth of Finance – April 30**

Thomas Philippon (2013), “[Has the U.S. Finance Industry Become Less Efficient? On the Theory and Measurement of Financial Intermediation](#)”, (Working Paper).

Robin Greenwood and David Scharfstein (2013), “[The Growth of Finance](#)”, *Journal of Economic Perspective* 27(2), Spring 2013: 3–28.

Kenneth R. French (2008), “[Presidential Address: The Cost of Active Investing](#)”, *Journal of Finance*, 63(4): 1537-1573.

Gennaioli, Nicola, Andrei Shleifer, and Robert Vishny (2012), “[Money Doctors](#)”, *Journal of Finance*, Forthcoming.

Gennaioli, Nicola, Andrei Shleifer, and Robert Vishny (2013), “[Finance and the Preservation of Wealth](#)”, Working Paper.