University of St.Gallen

9,176: Behavioural Finance

Subject information

ECTS-Credits: 2

Attached courses

Timetable	Language	Lecturer
9,176,1.00 Behavioural Finance	**English**	**De Giorgi Enrico**

Course information

Course prerequisites

Course content

Behavioural Finance has emerged has a new research field in finance addressing the impact of psychology on individual choice behaviour when making financial decisions, and the subsequent implications for asset markets. Behavioural Finance has successfully addressed several observed anomalies, that is, empirical facts that cannot be explained using traditional models in Finance. Prospect Theory of Daniel Kahneman and Amos Tversky, one of the pillar of Behavioural Finance, has been awarded with the Nobel Prize in Economics in 2002.

This course gives an introduction to Behavioural Finance. We start with a brief overview of *classical* paradigms for decision making under risk and the implications for portfolio selection and asset pricing. We then provide a description of market anomalies and inefficiencies, and discuss some psychological biases and limits of real investors that might generate those anomalies. We introduce the most important *descriptive* models for decision making under risk, focusing on the Prospect Theory of Kahneman and Tversky (1979), the Cumulative Prospect Theory of Tversky and Kahneman (1992), and on the concepts of loss aversion, probability weighting, and mental accounting. We finally study behavioural asset pricing models and behavioural models for portfolio selection, also discussing how the latter can be integrated into the advisory process of banks.

Course structure

1. **Introduction**
   Expected utility theory, risk attitudes, capital asset pricing model, efficient market hypothesis.
2. **Noise Traders Model and Application to the Closed-End Fund Puzzle**
   Noise traders, equilibrium implications, limited arbitrage
3. **Psychology for Finance**
   Psychological biases, prospect theory
4. **Behavioural Asset Pricing and Portfolio Selection**

Course literature

- De Giorgi, Enrico (2011): Behavioural Finance, Lecture Notes, HSG.
- Montier, James (2002): *Behavioral Finance*, John Wiley & Sons, New York.
- Shleifer, Andrei (2000): *Ineffcient Markets: An Introduction to Behavioral Finance*, Oxford University Press, Oxford.
- Reference to research papers will be given during the lectures.

Course additional information

Information about the Examination

Examination type

decentral - Oral examination (individual examination) (100%, 20 mins.)

Examination aids

no regulation necessary

No rules for examination aids are required for this examination.

- For written examinations at home (term paper), courses without credits, etc., no specific rules for examination aids are required.
- The regulations of the University of St. Gallen and the rules of academic work (sources and aids must always be identified) are applicable in a subsidiary fashion.

- All written work must be accompanied by a declaration of authorship.

Question language: **English**
Answer language: **English**

Examination content

1. **Introduction**
   Expected utility theory, risk attitudes (certainty equivalent, risk premium, Arrow-Pratt measure of risk aversion), violations of expected utility theory (Allais paradox, Ellsberg paradox), stochastic dominance concepts, mean-variance model, two-fund separation, capital asset pricing model, asset allocation puzzle, efficient market hypothesis (theoretical foundation).
2. **Noise Traders Model and Application to the Closed-End Fund Puzzle**
   Noise traders model (assumptions, economic intuition), equilibrium implications, closed-end fund puzzle (four sub-puzzles), classical explainations of the closed-end fund puzzle, exaplaination of the closed-end fund puzzle using the noise trader's model, empirical confirmation for the solution of the closed-end fund puzzle based on the noise traders' model.
3. **Psychology for Finance**
   Psychological biases (overconfidence, representativeness, anchoring, availability bias, gambler's fallacy), prospect theory (experimental foundation, editing phase, valuation phase, loss aversion), cumulative prospect theory.
4. **Behavioural Asset Pricing and Portfolio Selection**
   Equity premium puzzle, size and value premium puzzles, myopic loss aversion, narrow framing, behavioural reaward-risk model (and applications to the asset allocation puzzle), mean-variance with naive diversification.

Exam-relevant literature

De Giorgi, Enrico (2011): Behavioural Finance, Lecture Notes, HSG.

Attention please:

We would like to point out to you that this fact sheet has absolute priority over other information such as StudyNet, faculty members' personal databases, information provided in lectures, etc.

When will the fact sheets become binding?
Information about courses: from the start of the bidding process on 25 August 2011
Information about decentral examinations: after the 4th semester week on 17 October 2011
Information about central examinations: from the start of the enrolment period for the examinations on 7 November 2011

Please look at the fact sheet once more after these deadlines have expired.