

Behavioral Finance

Behavioral Finance

Module Number |

Degree | Bachelor

Semester | Summer

Course Type | Lecture/Tutorial

Participation Limit | None

Creditable for | Business & Economics (elective), Financial Management (elective), VWL (Economics) (elective)

Contact Hours | 4 SWS

Number of Credits | 5 ECTS

Language | English

Chair | Economics, esp. Macroeconomics

Lecturer | Prof. Dr. Simon Wiederhold

Learning Outcomes/Skills

- Behavioral finance uses insights from psychology to understand how human behavior influences the decisions of individual and professional investors, markets, and managers. Some decisions are simple, day-to-day choices, such as how hard we are going to study for the next test, or what brand of soda we are going to buy, but others significantly impact our financial wellbeing, such as whether we should buy a particular stock, or how we should allocate our money among various investment funds. The purpose of this lecture is to present what we have learned about financial decision-making from behavioral finance research.
- Students will refresh the foundations of modern finance: expected utility theory, asset pricing (CAPM), the efficient market hypothesis, and agency relationships.
- Students will become aware of the inability of these standard tools to account for various paradoxes and anomalies, leading to the genesis of behavioral finance as reflected in prospect theory. Students will be provided the theoretical foundation of this concept.
- Students will learn the psychological foundations of Behavioral Finance: cognitive limitations and heuristics, overconfidence, and emotion.
- Armed with this psychological background, students will learn how psychology impacts financial-decision making at the level of the individual. For instance, the lecture will investigate the extent to which the faulty use of heuristics leads to suboptimal financial decision-making (e.g., familiarity bias can lead to excessive domestic and local investment; availability bias pushes people into concentrating investments in securities where information is freely available).
- Students will become aware of the behavioral foundations of some central stock-market puzzles. For instance, in 1987 the Dow Jones fell by almost one quarter without any apparent reason. In this context, the recent financial crisis will also be discussed.
- A guest lecture with PwC representatives will familiarize students with the behavior and thinking of various stakeholders (banks, investors, employees) when a firm tumbles into crisis. Based on the insights from this lecture, students will themselves develop strategies to rescue crisis-laden firms in a case study.

Module Content

- Foundations of Neoclassical Finance
 - Expected Utility Theory
 - Asset Pricing, Market Efficiency, and Agency Relationships
- Theoretical Foundations of Behavioral Finance
 - Prospect Theory
 - Framing, and Mental Accounting
- Psychological Foundations of Behavioral Finance
 - Heuristics and Biases
 - Overconfidence
- Investor Behavior
 - Implications of Heuristics and Biases for Financial Decision-Making
 - Implications of Overconfidence for Financial Decision-Making
 - Individual Investors and the Force of Emotion
- Market Outcomes
 - Behavioral Explanations for Anomalies
 - Do Behavioral Factors Explain Stock Market Puzzles?
- Case Study PwC

Teaching methods/course type

- Lecture
- Tutorial
- Case study
 - The topic of the case study is a firm that enters a severe crisis (e.g., risk of bankruptcy). From the perspective of a consultancy, students will develop strategies to rescue the firm, which at the same time meet the expectations of the stakeholders (e.g., banks and employees).
 - Successfully finishing the case study also requires a number of soft skills, such as the ability to work in a team and presentation skills.

Types of examination and grading

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| ▪ Written exam (summer term 2020: see remarks!) | 100 % |
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Assessment criteria in detail

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| ▪ Written exam (90 minutes) at the end of the term. (summer term 2020: see remarks!) | |
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Workload

28 h = Time of attendance lecture
32 h = Preparation and postprocessing lecture
28 h = Time of attendance tutorial
30 h = Preparation and postprocessing tutorial (including the case study)
32 h = Exam preparation
150 h = Total workload

Previous Knowledge/Prerequisites in accordance with examination regulation

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| ▪ Basic knowledge in microeconomics and finance | |
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Readings

- | | |
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| ▪ Ackert, Lucy F. and Richard Deaves (2010). Behavioral Finance Psychology, Decision-Making, and Markets. Cengage Learning. | |
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Remarks

On the basis of the Corona regulations, we are offering a **portfolio** exam as an alternative examination type instead of a written exam for summer term 2020. Please register for the portfolio during the **first** examination registration period. The portfolio will be offered only **once** and there will be **no written exam!** Portfolio dates: Instructions to be distributed on July 27 2020, deadline for submission on August 10 2020 at 11:00 am. Further information regarding the content of the portfolio and further organizational details to be found on ILIAS.