Academic Year 2016-2017

**PSYCHOLOGY, ECONOMIC ANALYSIS, AND BEHAVIORAL FINANCE**

Prof. Nicola Gennaioli

## OVERVIEW

The course has two main objectives. The first is to introduce students to the discoveries of the new fields of behavioral economics and finance. The second is to equip students with basic methods for detecting psychology effects using field data on consumer and market behavior. These methods can inform research, policy, and industry work.

We will enrich standard choice models with psychological forces such as limited memory, salience, loss aversion, reference points, limited self-control. We will then show how these models can improve upon our ability to explain important facts on domains such as: consumer demand, expectation formation, savings and investment decisions, asset prices. The course alternates the analytics of distinct psychological mechanisms with their application to real world data.

## COURSE MATERIAL

Mandatory Books

- Kahneman, Daniel, 2011, *Thinking, Fast and Slow*, Farrar, Straus and Giroux
- Shleifer, Andrei, 2000, *Inefficient Markets: An introduction to Behavioral Finance*, Clarendon Lectures

Optional Books (suggestions for further reading)

- Thaler, Richard, and Cass Sunstein, 2008, *Nudge*, Yale University Press

- Gilovich, Thomas, Dale Griffin, and Daniel Kahneman (eds.), 2002, *Heuristics and Biases: the Psychology of Intuitive Judgment*, Cambridge University Press
- Shiller, Robert, 2005, *Irrational Exuberance*, Princeton University Press

Articles (all mandatory)

- Listed below the relevant class

Lecture Notes

These are especially useful to study formal models. The required level of formal analysis is the one of the lecture notes, not the one of the articles.

How to obtain Course Material

The books can be ordered at EGEA or on Amazon. Lecture notes and articles are made available in e-learning…**must fill in instructions on how to get there!!!**

**GRADING**

There will be one written final exam that covers the entire course material on **DATE!** (there will then be other general exams in January and February 2017).

**OFFICE HOURS**

Bocconi Faculty Building, Office 2-E2-09 (second floor), e-mail: nicola.gennaioli@unibocconi.it

Time: Mondays 18:00-19:00.

The next two pages of the syllabus describe the course program and the timetable of lectures in detail. Relevant readings are listed below each class.

**Lecture 1 (6/9, 14:30, room 25) Introduction to Behavioral Economics**

Kahneman, Daniel, *Thinking, Fast and Slow*.

**Lecture 2 (8/9, 10:30, room 25) Reference Dependence and Prospect Theory**

Kahneman, Daniel, *Thinking, Fast and Slow*.

Barberis, Nicholas, 2013, "Thirty Years of Prospect Theory in Economics: A Review and Assessment", *Journal of Economic Perspectives*, vol. 27, pp. 173-96.

**Lecture 3 (13/9, 8:45, room 25) Reference Dependence in the Field: NYC Cabs**

Camerer, Colin, Babcock, Linda, Loewenstein, George, and Thaler, Richard. "Labor supply of New York City Cabdrivers: One day at a time", 1997, *Quarterly Journal of Economics*, pp. 407-42.

**Lecture 4 (15/9, 10:30, room 25) Loss Aversion as a Source of Reference Dependence**

Genesove, David and Christopher Mayer. 2001. "Loss Aversion and Seller Behavior: Evidence from the Housing Market," *Quarterly Journal of Economics*, 116(4), 1233-1260.

**Lecture 5 (20/9, 8:45, room 25) The Endowment Effect**

Kahneman, Daniel, Jack L. Knetsch, and Richard H. Thaler, 1991, "Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias", *The Journal of Economic Perspectives*, Vol. 5, pp. 193-206.

**Lecture 6 (22/9, 10:30 room 25) The Disposition Effect**

Odean, Terry. 1998. "Are Investors Reluctant to Realize Their Losses?", *Journal of Finance*, pp. 1775-1798.

Barberis, Nicholas, and Wei Xiong, 2012, "Realization Utility", *Journal of Financial Economics*.

**Lecture 7 (27/9, 8:45, room 25) Salience, Reference Dependence and Decoy Effect**

Bordalo, Pedro, Nicola Gennaioli and Andrei Shleifer, 2013, "Salience and Consumer Choice", *Journal of Political Economics*.

**Lecture 8 (29/9, 10:30, room 25) Salience Effects in the Field**

Hastings, Justine, and Jesse Shapiro, 2013, "Fungibility and Consumer Choice: Evidence from Commodity Price Shocks", *Quarterly Journal of Economics*.

Simonsohn, Uri and George Loewenstein, 2006, "Mistake # 37: the Effect of Previously Encountered Prices on Housing Demand", *The Economic Journal*.

**Lecture 9 (4/10, 8:45, room 25) Anomalies in Choice under Risk in the Lab and Prospect Theory**

Kahneman, Daniel, and Amos Tversky, 1979, "Prospect Theory: An Analysis of Decision under Risk", *Econometrica*.

**Lecture 10 (6/10, 10:30, room 25) Anomalies in Choice under Risk in the Field**

Benartzi, Shlomo and Thaler, Richard. 1995. "Myopic loss aversion and the equity premium puzzle", *Quarterly Journal of Economics*, 110, pp.73-92.

Sydnor, Justin, 2010. “(Over)insuring Modest Risks.” *American Economic Journal: Applied Economics*, 2(4): 177–99.

**Lecture 11 (11/10, 8:45, room 25) Salience Effects in Choice under Risk**

Bordalo, Pedro, Nicola Gennaioli, and Andrei Shleifer, 2012, “Salience theory of Choice under Risk”, *Quarterly Journal of Economics*.

**Lecture 12 (13/10, 10:30, room 25) Heuristics and Biases: the Psychology of Beliefs**

Tversky, Amos and Daniel Kahneman, 1975, “Judgment under uncertainty: Heuristics and biases”, *Utility, probability, and human decision making*.

**Lecture 13 (25/10, 8:45, room 25) A Model of Representativeness-Based Thinking**

Gennaioli, Nicola and Andrei Shleifer, 2010, “What comes to Mind”, *Quarterly Journal of Economics*.

**Lecture 14 (27/10, 10:30, room 25) Representativeness and Social Stereotypes**

Coffman, Katie, Pedro Bordalo, Nicola Gennaioli, and Andrei Shleifer, 2016, “Stereotypes”, *Quarterly Journal of Economics*.

**Lecture 15 (3/11, 10:30, room 25) Representativeness and Non-Rational Expectations**

Gennaioli, Nicola, Yueran Ma, and Andrei Shleifer, 2016, “Expectations and Investment”, *NBER MacroAnnual*.

**Lecture 16 (8/11, 8:45, room 25) Overconfidence, with an Application to Industry Mergers**

Malmendier, Ulrike, and Geoffrey Tate. “Who Makes Acquisitions? CEO Overconfidence and the Market's Reaction,” *Journal of Financial Economics* Volume 89, Issue 1, July 2008, Pages 20-43.

**Lecture 17 (15/11, 8:45, room 25) Intertemporal Preferences: Self Control Problems**

O'Donoghue, Ted, and Matthew Rabin, 1999, “Doing It Now or Later”, *The American Economic Review*, Vol. 89, pp. 103-124.

**Lecture 18 (17/11, 10:30, room 25) Self Control in the Field: Physical Exercise and**

**Saving**

DellaVigna, Stefano and Malmendier, Ulrike. 2006. “Paying Not To Go To The Gym”, *American Economic Review*, 96(3): 694-719.

Angeletos, George-Marios, David Laibson, Andrea Repetto, Jeremy Tobacman, and Stephen Weinberg, 2001, “The Hyperbolic Consumption Model: Calibration, Simulation, and Empirical Evaluation”, *The Journal of Economic Perspectives*, Vol. 15, pp. 47-68.

**Lecture 19 (22/11, 8:45, room 25) Behavioral Finance: the Basic Anomalies**

Shleifer, Andrei, 2000, *Inefficient Markets: An introduction to Behavioral Finance*, chapter 1.

Barberis, Nicholas, and Richard Thaler, 2003, A survey of behavioral finance, *Handbook of the Economics of Finance*, Elsevier.

**Lecture 20 (24/11, 10:30, room 25) Limits to Arbitrage**

Shleifer, Andrei, 2000, *Inefficient Markets: An introduction to Behavioral Finance*, chapters 2, 3, 4.

**Lecture 21 (29/11, 8:45, room 25) Expectations of Stock Returns**

Greenwood, Robin, and Andrei Shleifer, 2014, Expectations of returns and expected returns, Review of Financial Studies.

Barberis, Nicholas, Robin Greenwood, Lawrence Jin, and Andrei Shleifer, 2015, X-CAPM: An extrapolative capital asset pricing model, Journal of Financial Economics.

**Lecture 22 (1/12, 10:30, room 25) Over-reaction and the Cross Section of Stock Returns**

La Porta, Rafael, 1996, Expectations and the cross-section of stock returns, The Journal of Finance.

**Lecture 23 (2/12, 10:30, room 25) Credit Cycles and Financial Crises**

Greenwood, Robin, and Sam Hanson, 2013, Issuer quality and corporate bond returns, Review of Financial Studies.

Bordalo, Pedro, Nicola Gennaioli, and Andrei Shleifer, Diagnostic Expectations and Credit Cycles.

**Lecture 24 (6/12, 8:45, room 25) Retail Investors, Marketing, and Risk Taking**

Celerier, Claire, and Boris Vallee, 2015, Catering to Investors Through Product Complexity, mimeo, Harvard Business School.