

Fudan University School of Economics

Jiang Xuemo Lecturing Platform

Segment: Behavioural Finance

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Course Objectives:

Standard finance theory finds a hard time in explaining several phenomena associated to the behaviors of individual investors and of financial markets. In the past 30 years, several so-called puzzles have been systematically documented. In response to these puzzles, behavioral finance has emerged to develop alternative approaches relaxing standard assumptions about investors' preferences, beliefs, and rationality. The aim is to make more realistic assumptions on how investors process information, how they form beliefs, how they perceive risk and, as a result, try to make more accurate predictions. A novel and particularly interesting angle to address these issues come from the rise of fintech services, which may have the potential of helping investors be less exposed to behavioral biases and possibly improve the efficiency of financial markets.

This course is intended to present and propose a discussion of the most recent developments in behavioral finance, with applications to household finance and financial markets. In each lecture, we will present some important departure from the standard framework, in terms of preferences, beliefs, or cognitive resources. We will see how those departures can be incorporated into models of decision making and of market interactions. We will discuss how those richer models can be used to analyze financial choices and asset markets in the field. We will consider issues related to portfolio choices including the disposition effect, portfolio inertia, under participation and under diversification, under saving, short-termism. We will see how those choices lead to financial market phenomena such as excessive trading volume, mispricing, excessive volatility, market inefficiency.

Content

Part 1: Non-standard preferences and beliefs

(Prospect Theory, Ambiguity aversion, Overconfidence, Social Preferences)

Part 2: Limited cognitive resources

(Limited attention, Limited strategic thinking)

Part 3: Portfolio choices and asset prices in the fintech era

(Behavioral biases in online platforms, Robo-advisors, AI in Finance)

By the end of this course, students should be able to:

- Evaluate portfolio choices and asset prices in light of recent insights in behavioral finance
- Assess the impact of fintech on individual investors and financial markets
- Discuss critically papers at the research frontier

- Elaborate novel research ideas

Prerequisites :

Basic micro and econometrics.

Bibliography/references:

Surveys:

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Beshears, J. and Choi, J.J. and Laibson, D. and Madrian, B.C. (2018), Behavioral Household Finance. NBER Working Paper No. w24854

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Papers (PRELIMINARY):

Part 1

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Bianchi, Milo and Wang, Gang and Liu, Zhengkai, (2022) Are We Becoming Greener? Life-time Experiences and Responsible Investment. Available at SSRN: <https://ssrn.com/abstract=4003445>

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Malmendier, Ulrike. (2021) "Experience effects in finance: Foundations, applications, and future directions." *Review of Finance* 25.5 1339-1363.

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Part 2

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Barber, B. M. and Odean, T. (2008) "All That Glitters: The Effect of Attention and News on the Buying Behavior of Individual and Institutional Investors," *Review of Financial Studies*, 21(2), 785-818.

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Bianchi, M., and P. Jehiel. (2020) "Bundlers' dilemmas in financial markets with sampling investors." *Theoretical Economics* 15.2: 545-582.

Dellavigna, S. & Pollet, J. M. (2009) "Investor Inattention and Friday Earnings Announcements," *Journal of Finance*, 64(2), 709-749.

Hirshleifer, D. and Teoh, S.H. (2003) "Limited attention, information disclosure, and financial reporting," *Journal of Accounting and Economics*, 36(1-3), 337-386.

Nagel, R "Unraveling in Guessing Games: An Experimental Study", *American Economic Review*, 1995, vol. 85(5), pages 1313-26

Simon, Herbert - A Behavioral Model of Rational Choice - *Quarterly Journal of Economics*, Vol. 69, No. 1. (Feb., 1955), pp. 99-118.

Teoh, S.H., Welch, I. and Wong, T.J. (1998) "Earnings Management and the Long-Run Market Performance of Initial Public Offerings," *Journal of Finance*, 53(6): 1935-1974.

Part 3

Bianchi, M. and Brière, M. (2021), "Augmenting Investment Decisions with Robo-Advice", Available at SSRN: <https://ssrn.com/abstract=3751620>

Bianchi, M. and Brière, M. (2022), "Robo-Advising: Less AI and More XAI?" in *Machine Learning and Data Science in Financial Markets*, Cambridge University Press.

Buchanan, B. (2019), 'Artificial intelligence in finance', Available at <http://doi.org/10.5281/zenodo.2612537>.

D'Acunto, F. Prabhala, N. and Rossi, A. (2019), "The Promises and Pitfalls of Robo-advising" - *Review of Financial Studies*, 32(5), 1983-2020.

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Jordan, M. I. (2019), 'Dr. AI or: How I learned to stop worrying and love economics', *Harvard Data Science Review* 1(1).

Miller, T. (2019), 'Explanation in artificial intelligence: Insights from the social sciences', *Artificial Intelligence* 267, 1-38.

Philippon, T. (2019), 'On fintech and financial inclusion', *NBER Working Paper No. 26330*