Behavioral Finance

CRN: 28921  
Course Number: 672  
Department (unused): ECON  

Description:  
Much of modern financial economics works with models in which agents are rational, in that they maximize expected utility and use Bayes’s law to update their beliefs. Behavioral finance is a large and active field that studies models in which some agents are less than fully rational. Such models have two building blocks: limits to arbitrage, which make it difficult for rational traders to undo the dislocations caused by less rational traders; and psychology, which catalogues the kinds of deviations from full rationality we might expect to see. We discuss these two topics and then consider a number of applications: asset pricing (the aggregate stock market and the cross-section of average returns); individual trading behavior; and corporate finance (security issuance, corporate investment, and mergers).

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