Much of modern financial economics works with models in which agents are rational, in that they maximize expected utility and use Bayes’ law to update their beliefs. Behavioral finance is a large and active field which 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). This is a research-oriented course aimed at Ph.D. students. Undergraduate students with outstanding academic records and prior experience of graduate courses may register with the instructor’s permission. Grades will be based on a small number of referee reports and a final exam.

Semester offered: Spring

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