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PHDBA 297T: INEFFICIENT MARKETS

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Course Description

Traditional finance is fundamentally based on the premise that investors and managers are rational and that asset prices are "efficient". However, this paradigm is insufficient to describe many features of actual financial markets. This course is a Ph.D. level exploration of research papers that help us understand how institutional and behavioral frictions affect financial markets and therefore financial decision-making.

The evaluation will be based on the replication/extension of an empirical paper. Students should select an empirical academic paper related to one of the topics studied in class and replicate it. Once the replication is done, I expect the students to propose several potential extensions to the paper, and empirically implement at least one of them. This could be the basis for a research paper.

PHDBA 297T will consist essentially of (hopefully interactive) lectures. The course will meet in classroom C337 at Haas from 1:10 PM - 4:00 PM on Fridays.

Readings

Class notes will be posted to the bCourse website. There is no textbook for this course. In fact, there are no real textbook yet in behavioral finance/ inefficient markets. Inefficient Markets (Oxford UP) by Andrei Shleifer provides a good coverage of some of the themes we will explore together and thus constitutes an interesting read.

Topics

I am tentatively putting up this syllabus but I expect it to change over the course of the semester.

Anomalies
References:

- Asness, Moskowitz and Pedersen 2013. Value and momentum everywhere. *Journal of Finance*
- Black, Jensen and Scholes 1972. The capital asset pricing model: some empirical tests. *Studies in the Theory of Capital Markets, Praeger, NY*
- Bernard 1992. Stock Price Reactions to Earnings Announcements. In: Thaler, R. (Ed.), Advances in Behavioral Finance. New York: Russell Sage Foundation.
- Campbell and Shiller 1988. The dividend-price ratio and expectations of future dividends and discount factors. *Review of Financial Studies*
- Cochrane 2011. *Asset pricing,* chapter 1, 2, 9. Princeton University Press
- Cochrane 2011. Presidential address: discount rates. *Journal of Finance*
- Cohen and Frazzini (2008). Economic Links and Predictable Returns. *Journal of Finance*
- DeBondt and Thaler 1985. Does the stock market overreact? *Journal of Finance*
- Fama and French 1992. The cross-section of expected stock returns. *Journal of Finance*
- Fama and French 1993. Common risk factors in the returns on stock and bonds. *Journal of Financial Economics*
- Fleckenstein, Longstaff and Lustig 2013. The TIPS–Treasury bond puzzle. *Journal of Finance*
- Jegadeesh and Titman 1993. Returns to buying winners and selling losers: implications for stock market efficiency. *Journal of Finance*
- Huberman and Regev 2001. Contagious Speculation and a Cure for Cancer: A non-event that Made Stock Prices Soar. *Journal of Finance*
- Hwang (2011). Country-specific sentiment and security prices. *Journal of Financial Economics*
- Keim 1983. Size-related Anomalies and Stock Return Seasonality. *Journal of Financial Economics*
- Lamont and Thaler 2003. Can the Market Add and Subtract? Mispricing in Tech Stock Carve-Outs. *Journal of Political Economy*
- Lakonishok and Shmidt 1988. Are seasonal anomalies real? A ninety-year perspective. *Review of Financial Studies*
- Lucca and Moench (Forthcoming). The Pre-FOMC Announcement Drift. *Journal of Finance*
- Mehra and Prescott 1985. The equity premium: a puzzle. *Journal of Monetary Economics*
- Saunders, Edward 1993. Stock Prices and Wall Street Weather. *Journal of Finance*
- Shiller 1981. Do stock prices move too much to be justified by subsequent changes in dividends? *American Economic Review*

Risky Arbitrage

References:

- Cheng, Hong and Liskovich 2015. Regression discontinuity and the price effects of stock market indexing. *Review of Financial Studies*
- Coval and Stafford 2007. Asset fire sales (and purchases) in equity markets. *Journal of Financial Economics*
- Mitchell, Mark, Todd Pulvino, and Erik Stafford (2002). Limited Arbitrage in Equity Markets. Journal of Finance, 57: 551-584.
- De Long, Shleifer, Summers and Waldmann 1990. Noise trader risk in financial markets. *Journal of Political Economy*
- Foucault, Sraer and Thesmar 2011. Individual investors and volatility. *Journal of Finance*
- Scruggs 2007. Noise trader risk: Evidence from the Siamese twins,*Journal of Financial Markets*
- Wurgler and Zhuravskaya 2002. Does arbitrage flatten demand curves for stocks? *Journal of Business*

Asset pricing with shorting costs. The risk-return puzzle.

References:

- Ang, Hodrick, Xing and Zhang 2006. The Cross-Section of Volatility and Expected Returns. *Journal of Finance*
- Baker, Brendan and Wurgler 2011. Benchmarks as limits to arbitrage: Understanding the low volatility anomaly. *Financial Analysts Journal*
- Chen, Hong and Stein 2003. Breadth of Ownership and Stock Returns. *Journal of Financial Economics*
- D'avolio 2002. The market for borrowing stock. *Journal of Financial Economics*.
- Miller 1977. Risk, uncertainty, and divergence of opinion. *Journal of Finance*
- Diether, Malloy and Scherbina 2002. Differences of Opinion and the Cross-Section of Stock Returns*Journal of Finance*.
- Hong and Sraer (2014). Speculative Betas. Working Paper.

Asset pricing with Leverage Constraints

References:

- Adrian, Etula and Muir 2014. Financial intermediaries and the cross-section of asset returns. *Journal of Finance*
- Adrian, Moench and Shin 2013. Leverage asset pricing
- Adrian and Shin 2010. Liquidity and leverage. *Journal of Financial Intermediation*
- Adrian and Shin 2014. Procyclical leverage and value-at-risk. *Review of Financial Studies*
- Ang, Gorovyy and van Inwegen 2011. Hedge fund leverage. *Journal of Financial Economics*
- Brunnermeier and Pedersen 2009. Market liquidity and funding liquidity. *Review of Financial Studies*
- Frazzini and Pedersen 2014. Betting against Beta. *Journal of Financial Economics*
- Garleanu and Pedersen 2011. Margin-based asset pricing and deviations from the law of one price. *Review of Financial Studies*
- Gorton and Metrick 2011. Securitized banking and the run on repo. *Journal of Financial Economics*

- Gromb and Vayanos 2002. Equilibrium and welfare in markets with financially constrained arbitrageurs. *Journal of Financial Economics*
- Gromb and Vayanos 2010. Limits of arbitrage: the state of the theory. *Annual Review of Financial Economics*
- Gromb and Vayanos 2012. Financially constrained arbitrage and cross-market contagion. *Working Paper*
- Hombert 2009. Solvency shocks, liquidity shocks, and fire sales
- Lorenzoni 2008. Inefficient credit booms. *Review of Economic Studies*

Arbitrage Capital

References:

- Hombert and Thesmar 2014. Overcoming limits of arbitrage: theory and evidence. *Journal of Financial Economics*
- Lou 2012. A flow-based explanation for return predictability. *Review of Financial Studies*
- Lou and Polk 2014. Comomentum: inferring arbitrage activity from return correlations
- Mitchell, Pedersen and Pulvino 2007. Slow moving capital. *American Economic Review*
- Shleifer and Vishny 1997. The limits of arbitrage. *Journal of Finance*
- Stein 2005. Why are most funds open-end? Competition and the limit of arbitrage. *Quarterly Journal of Economics*
- Stein 2009. Presidential address: sophisticated investors and market efficiency. *Journal of Finance*

Career Concerns and Delegated Management

References:

- Brunnermeier, Nagel and Pedersen 2008. Carry trades and currency crashes. *NBER Macroeconomics Annual*
- Chevalier and Ellison 1999. Career concerns of mutual fund managers. *Quarterly Journal of Economics*
- Dasgupta, Prat and Verardo 2011. Institutional trade persistence and long-term Equity returns. *Journal of Finance*
- Guerrieri and Kondor 2013. Fund managers, career concerns, and asset price volatility. *American Economic Review*
- Mitchell and Pulvino 2001. Characteristics of risk and return in risk arbitrage. *Journal of Finance*
- Scharfstein and Stein 1990. Herd behavior and investment. *American Economic Review*
- Sias 2004. Institutional herding. *Review of Financial Studies*

Bubbles and Market Timing

References:

- Survey: Brunnermeier and Oehmke 2013. Bubbles, financial crises, and systemic risk. *Handbook of the economics of finance*

- Abreu and Brunnermeier 2002. Synchronization risk and delayed arbitrage. *Journal of Financial Economics*
- Abreu and Brunnermeier 2003. Bubbles and crashes. *Econometrica*
- Allen and Gale 2000. Bubbles and crises. *Economic Journal*
- Allen and Gorton 1993. Churning bubbles. *Review of Economic Studies*
- Blanchard and Watson 1982. Bubbles, rational expectations, and financial markets. *Crisis in the Economic and Financial Structure*
- Brunnermeier and Nagel 2004. Hedge funds and the technology bubble. *Journal of Finance*
- Chevalier and Ellison 1997. Risk taking by mutual funds as a response to incentives. *Journal of Political Economy*
- Fahlenbrach and Stulz 2011. Bank CEO incentives and the credit crisis. *Journal of Financial Economics*
- Jensen and Meckling 1976. Theory of the firm: managerial behaviour, agency cost and ownership structure. *Journal of Financial Economics*
- Tirole 1985. Asset bubbles and overlapping generations. *Econometrica*
- Scheinkman and Xiong 2003. Overconfidence and speculative bubbles. *Journal of Political Economy*
- Survey: Baker and Wurgler 2013. Behavioral corporate finance: an updated survey. *Handbook of the economics of finance*
- Baker and Wurgler 2000. The equity share in new issues and aggregate stock returns. *Journal of Finance*
- Graham and Harvey 2001. The theory and practice of corporate finance: Evidence from the field. *Journal of Financial Economics*
- Khan, Kogan and Serafeim 2012. Mutual fund trading pressure: Firm-level stock price impact and timing of SEOs. *Journal of Finance*

Asset pricing with biases

References:

- Barber and Odean 2001. Buys will be boys: Gender, overconfidence, and common stock investment. *Quarterly Journal of Economics*
- Barberis, Huang and Santos, 2001. Prospect Theory and Asset Prices. *Quarterly Journal of Economics*
- Barberis, Huang and Thaler, 2006. Individual Preferences, Monetary Gambles, and Stock Market Participation: A Case for Narrow Framing. *American Economic Review*
- Cohen and Frazzini 2008. Economic links and predictable returns. *Journal of Finance*
- Greenwood and Shleifer 2014. Expectations of returns and expected returns. *Review of Financial Studies*
- Huberman and Regev 2001. Contagious speculation and a cure for cancer: A nonevent that made stock prices soar. *Journal of Finance*
- Malmendier and Nagel 2011. Depression babies: Do macroeconomic experiences affect risk taking. *Quarterly Journal of Economics*
- Milgrom and Stokey 1982. Information, trade and common knowledge. *Journal of Economic Theory*
- Tetlock 2011. All the news that's fit to reprint: Do investors react to stale information? *Review of Financial Studies*