

Title: THE STATE OF BEHAVIORAL FINANCE

Speaker: NICHOLAS BARBERIS
Yale University

Importance: Why this matters:
The classic economic model of rational utility maximization fails to explain many types of investor and market behavior. Behavioral finance has linked better descriptions of investor decision making to those “anomalous” findings. The survey summarized many of those models and findings.

Investigation: "Speaker analyzed XXX data to address the questions yyy, zzz, etc."
Barberis provided a survey of the history of Behavioral Finance, and the current “state of the art”.
He used three behaviors: over-extrapolation, overconfidence and gain-loss utility with prospect theory to illustrate behavioral finance’s ability to explain many asset pricing issues. They include: average returns, time series predictability, momentum and reversals, bubbles and trading volume.

Innovation: Are there new techniques of interest in the data or approach to the problem?
The survey covered many of the behavioral finance innovations. They include using surveys and games to better understand investor behavior.

Insights: 1-2-3, what are the three most important things the speaker offered?

7. Behavioral Finance tries to make sense and create models where market participants do not fit the “classic model” (e.g. their behavior is not “fully rational”). The models are psychologically more realistic.
8. Behavioral finance has been successful by developing new models, making predictions, and conducting empirical tests.
Behavioral finance has been successful in explaining observed facts.
 - Over-extrapolation explains momentum and reversals, time series predictability, and bubbles.
 - Overconfidence explains overplacement (rosy views of their relative ability) and overprecision (over confidence in the accuracy of their forecasts).
 - Gain-loss utility with prospect theory (reference dependence and loss aversion) provides a better description of investors’ decision making than classic utility maximization.

Audience rating: 4.47