

1: Rational Behavior

Behavioral Finance is an important topic on the CFA Level 3 exam. Investment Advisors often use Behavioral Finance analysis to better understand their clients' needs and investment requirements.

Nudge theory Richard Thaler , winner of the Nobel Prize in economics Nudge is a concept in behavioral science , political theory and economics which proposes positive reinforcement and indirect suggestions as ways to influence the behavior and decision making of groups or individuals. Nudging contrasts with other ways to achieve compliance, such as education , legislation or enforcement. The concept has influenced British and American politicians. The first formulation of the term and associated principles was developed in cybernetics by James Wilk before and described by Brunel University academic D. Stewart as "the art of the nudge" sometimes referred to as micronudges [37]. It also gained a following among US and UK politicians, in the private sector and in public health. To count as a mere nudge, the intervention must be easy and cheap to avoid. Nudges are not mandates. Putting fruit at eye level counts as a nudge. Banning junk food does not. In this form, drawing on behavioral economics, the nudge is more generally applied to influence behaviour. In other words, a nudge alters the environment so that when heuristic, or System 1, decision-making is used, the resulting choice will be the most positive or desired outcome. Regarding its application to HSE, one of the primary goals of nudge is to achieve a "zero accident culture". These companies are using nudges in various forms to increase the productivity and happiness of employees. Recently, further companies are gaining interest in using what is called "nudge management" to improve the productivity of their white-collar workers. Ethicists have debated this rigorously. Similarly, legal scholars have discussed the role of nudges and the law.

Behavioral finance[edit] Robert J. Shiller , winner of the Nobel Prize in economics The central issue in behavioral finance is explaining why market participants make irrational systematic errors contrary to assumption of rational market participants. The study of behavioral finance also investigates how other participants take advantage arbitrage of such errors and market inefficiencies. Behavioral finance highlights inefficiencies, such as under- or over-reactions to information, as causes of market trends and, in extreme cases, of bubbles and crashes. Such reactions have been attributed to limited investor attention, overconfidence, overoptimism, mimicry herding instinct and noise trading. Loss aversion appears to manifest itself in investor behavior as a reluctance to sell shares or other equity if doing so would result in a nominal loss. Benartzi and Thaler, applying a version of prospect theory , claim to have solved the equity premium puzzle , something conventional finance models so far have been unable to do. Quantitative behavioral finance[edit] Quantitative behavioral finance uses mathematical and statistical methodology to understand behavioral biases. In marketing research, a study shows little evidence that escalating biases impact marketing decisions. One characteristic of overreaction is that average returns following announcements of good news is lower than following bad news. In other words, overreaction occurs if the market reacts too strongly or for too long to news, thus requiring an adjustment in the opposite direction. As a result, outperforming assets in one period is likely to underperform in the following period. They contend that behavioral finance is more a collection of anomalies than a true branch of finance and that these anomalies are either quickly priced out of the market or explained by appealing to market microstructure arguments. However, individual cognitive biases are distinct from social biases; the former can be averaged out by the market, while the other can create positive feedback loops that drive the market further and further from a " fair price " equilibrium. Similarly, for an anomaly to violate market efficiency, an investor must be able to trade against it and earn abnormal profits; this is not the case for many anomalies. It is argued that the cause is entry barriers both practical and psychological and that returns between stocks and bonds should equalize as electronic resources open up the stock market to more traders. Experiments include testing deviations from typical simplifications of economic theory such as the independence axiom [77] and neglect of altruism , [78] fairness , [79] and framing effects. Early attempts along these lines focus on the behavior of rats and pigeons. These studies draw on the tenets of

comparative psychology , where the main goal is to discover analogs to human behavior in experimentally -tractable non-human animals. They are also methodologically similar to the work of Ferster and Skinner. Recent studies have adopted a slightly different approach, taking a more evolutionary perspective, comparing economic behavior of humans to a species of non-human primate , the capuchin monkey. These studies looked at things like peck rate in the case of the pigeon and bar-pressing rate in the case of the rat given certain conditions of reward. Use of this laboratory is predicated on the fact that behavior, as well as structure, vary continuously across species, and that principles of economic behavior would be unique among behavioral principles if they did not apply, with some variation, of course, to the behavior of nonhumans. Labor supply[edit] The typical laboratory environment to study labor supply in pigeons is set up as follows. Pigeons are first deprived of food. Since the animals become hungry, food becomes highly desired. The pigeons are then placed in an operant conditioning chamber and through orienting and exploring the environment of the chamber they discover that by pecking a small disk located on one side of the chamber, food is delivered to them. In effect, pecking behavior becomes reinforced , as it is associated with food. Before long, the pigeon pecks at the disk or stimulus regularly. In this circumstance, the pigeon is said to "work" for the food by pecking. The food, then, is thought of as the currency. The value of the currency can be adjusted in several ways, including the amount of food delivered, the rate of food delivery and the type of food delivered some foods are more desirable than others. Researchers argue that this is similar to labor supply behavior in humans. That is, like humans who, even in need, will only work so much for a given wage , the pigeons demonstrate decreases in pecking work when the reward value is reduced. This means that as the price of a certain good increase, the amount that consumers are willing and able to purchase decreases. Researchers studying the demand curves of non-human animals, such as rats, also find downward slopes. Researchers have studied demand in rats in a manner distinct from studying labor supply in pigeons. Specifically, in an operant conditioning chamber containing rats as experimental subjects, we require them to press a bar, instead of pecking a small disk, to receive a reward. The reward can be food reward pellets , water, or a commodity drink such as cherry cola. Unlike in previous pigeon studies, where the work analog was pecking and the monetary analog was a reward, the work analog in this experiment is bar-pressing. Under these circumstances, the researchers claim that changing the number of bar presses required to obtain a commodity item is analogous to changing the price of a commodity item in human economics.

2: The Economist on Behavioral Finance – The Rational Walk

Behavioral finance has come to a place of prominence in the past decades, with many academics adhering to its principles. However, this set of theories is not without critics, too.

Why is behavioral finance necessary? Theories like these take as an assumption that participants in an economy, for the most part, exhibit behaviors that are rational and predictable. There was a time when theoretical and empirical evidence seemed to suggest that CAPM, EMH and other conventional financial theories were reasonably successful at predicting and explaining certain types of economic events. Nonetheless, as time went on, academics in the financial and economic realms detected anomalies and behaviors which occurred in the real world but which could not be explained by any available theories. According to conventional theories, people are able to separate out emotions and various other extraneous factors so that they are not susceptible to their influence. In reality, though, this assumption does not reflect how people tend to behave. Indeed, nearly every participant in an economy behaves irrationally in some way or other. To take a common example: Taken logically, it does not make any sense to buy a lottery ticket if the odds of winning are overwhelmingly against the ticket holder the chances of winning the Powerball jackpot are roughly 1 in million, or 0. However, in spite of this, millions of people spend countless dollars taking part in the lottery. Anomalies like this one provoked academics to turn to cognitive psychology in order to account for irrational and illogical behaviors which are unexplained by modern financial theory. Important Contributors Behavioral finance has developed to the point it has today thanks to the contributions of many individual theorists and researchers. Daniel Kahneman and Amos Tversky Kahneman and Tversky are considered by many to be the fathers of behavioral finance. These two cognitive psychologists began to collaborate with one another in the late s, ultimately publishing about works in the field. Most of the work of Kahneman and Tversky focuses on how various psychological concepts relate to behavior in the financial realm. In , Kahneman received the Nobel Memorial Prize in Economic Sciences for his contributions to the study of rationality in economics. Kahneman and Tversky have specialized on cognitive biases and heuristics i. Richard Thaler If it can be said that Kahneman and Tversky were the founders of behavioral finance, it follows that Richard Thaler brought the field out of its nascent state and into the mainstream. Thaler developed his theories out of a growing awareness of the shortcomings of conventional financial theories as they pertain to real-world behaviors. After he read a draft version of a work by Kahneman and Tversky on prospect theory, Thaler came to the realization that psychological theory rather than conventional economics could help to account for this irrationality. Critics of Behavioral Finance Behavioral finance has come to a place of prominence in the past decades, with many academics adhering to its principles. However, this set of theories is not without critics, too. For instance, some supporters of the efficient market hypothesis EMH are vocal critics of behavioral finance. EMH is widely considered to be one of the foundations of modern finance. However, this hypothesis fails to account for irrationality, because it assumes that the market price of a security reflects the impact of any and all relevant information as it becomes available. Eugene Fama is one of the most notable critics of behavioral finance. Fama is the founder of market efficiency theory. He suggests that even though there do exist some anomalies for which modern financial theory is not able to account, market efficiency theory remains the best model for examining and predicting economies. Fama even goes so far to note that many anomalies inherent in conventional theories could be seen as shorter-term chance events which are eventually corrected as time goes on. Critics Although behavioral finance has been gaining support in recent years, it is not without its critics. Some supporters of the efficient market hypothesis, for example, are vocal critics of behavioral finance. The efficient market hypothesis is considered one of the foundations of modern financial theory. However, the hypothesis does not account for irrationality because it assumes that the market price of a security reflects the impact of all relevant information as it is released. The most notable critic of behavioral finance is Eugene Fama, the founder of market efficiency theory. Professor Fama suggests

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that even though there are some anomalies that cannot be explained by modern financial theory, market efficiency should not be totally abandoned in favor of behavioral finance. In fact, he notes that many of the anomalies found in conventional theories could be considered shorter-term chance events that are eventually corrected over time. In his paper, entitled "Market Efficiency, Long-Term Returns And Behavioral Finance", Fama argues that many of the findings in behavioral finance appear to contradict each other, and that all in all, behavioral finance itself appears to be a collection of anomalies that can be explained by market efficiency.

3: Rational Portfolio

Behavioral finance attempts to model behaviors that on the surface appear irrational.

4: Behavioral economics - Wikipedia

The Irrational Investor and Behavioral Finance. Investors do crazy things for odd reasons, but experts are getting a grip on investment's human side.

5: Behavioral Finance | IE

A) Behavioral Finance - The Behavioral Finance Perspective study guide by cmac includes 38 questions covering vocabulary, terms and more. Quizlet flashcards, activities and games help you improve your grades.

6: Investor Junkie Is Not Available In Your Country - Investor Junkie

In this paper we address three main objections of behavioral finance to the theory of rational finance, considered as anomalies the theory of rational finance cannot explain: Predictability of.

7: Behavioral Finance – Benefiting from Irrational Investors

As a follow up to yesterday's article on behavioral finance, it is worth listening to the views of Greg Davies, the head of Behavioral Finance at Barclays. In the "Tea with the Economist" segment shown below, Mr. Davies discusses common psychological tendencies of investors particularly with respect to risk and aversion to loss.

8: Behavioral Finance: Background

Behavioral Finance 2 ©, The Research Foundation of CFA Institute One aspect of the discussion about rational and irrational investors that is important to consider is the extent.

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Analysis and Simulation of Chaotic Systems (Applied Mathematical Sciences) A case of letter-by-letter reading Linda Garcia Interior design studio book Tibetan Traditions of Metal Sculptures Listen, children, listen Jazz scott deveaux second edition Importance of human resource department Mechanics of materials beer 4th edition Customer centric project management Prayer of St. Alphonsus Liguori to Mary 683 IRS employees claims for reimbursement for cable television charges] The scope of satire. Valley of Bones CD Stories from old-fashioned childrens books. Modern art and modernism A summer burning. Student Supplement package for Living with Art, 5th ed. Modeling of thermal performance of multiphase nuclear fuel cell under variable gravity conditions Heikes Huntsville trees Next Exit (Next Exit: The Most Complete Interstate Highway Guide Ever Printed) Beatrix Potters Peter Rabbit Rebus Book African Political Systems Paris Interiors (Midsize) Walmart 10k report 2014 Whales (Blastoff! Readers (Oceans Alive (Oceans Alive) Indicadores De LA Compension Lectora The anthropological exhibits at the American Museum of Natural History George A. Dorsey Optics in Astronomy Wont from gmail New age youth and masonry Narrative structure in the Byzantine vernacular romances Grandparenting in a Changing World Robert Blake; general-at-sea Money changes everything how finance made civilization possible Moonlit upper deckerina The Invalides and the Champ-de-Mars Marcel Brion Dictionary of painting and decorating Music merit badge worksheet Track, enduro, and motocross-unless you fall over The Peoples Machine