Written Exam at the Department of Economics winter 2019-20

Behavioural Finance

Final Exam

18-12-2019

(2-hour closed book exam)

This exam question consists of 2 pages in total

Falling ill during the exam
If you fall ill during an examination at Peter Bangs Vej, you must:

- contact an invigilator who will show you how to register and submit a blank exam paper.
- leave the examination.
- contact your GP and submit a medical report to the Faculty of Social Sciences no later than five (5) days from the date of the exam.

Be careful not to cheat at exams!
You cheat at an exam, if during the exam, you:

- Make use of exam aids that are not allowed
- Communicate with or otherwise receive help from other people
- Copy other people's texts without making use of quotation marks and source referencing, so that it may appear to be your own text
- Use the ideas or thoughts of others without making use of source referencing, so it may appear to be your own idea or your thoughts
- Or if you otherwise violate the rules that apply to the exam.

Please answer all questions as concise and short as possible!

Good Luck!

Question 1 – Overconfidence

a) Explain the different notions of overconfidence that we discussed in class. Which notion of overconfidence is used in Malmendier & Tate (2005), CEO Overconfidence and Corporate Investment, JFE, 60(6), 2661-2700? Explain.

b) Explain the different kinds of consequences that overconfidence might have on the financial decisions of traders and managers. Please discuss in particular the results of Barber & Odean, 2001, Boys will be Boys: Gender, Overconfidence, and Common Stock Investment, QJE, 116(1), 261-292

Question 2 – Decision under risk and uncertainty

In our financial decisions, we are often faced with risk and uncertainty.

a) Please explain prospect theory. In your explanation, please highlight clearly its difference to expected utility theory.

b) How can prospect theory explain the disposition effect? Furthermore, explain the empirical evidence presented in Weber & Camerer (1998), The disposition effect in securities trading: an experimental analysis, Journal of Economic Behavior & Organization, Vol. 33, 167-184

Question 3 – Under and Overreaction to news

a) Please explain the model presented in Nicholas Barberis, Andrei Shleifer & Robert Vishny (1998), A model of investor sentiment, Journal of Financial Economics, 49, 307-343. Define under and overreaction to news announcements.

b) Explain the conservatism bias and the representativeness heuristic. How can these two biases explain the over- and under-reaction featured in the model by Barberis et al. (1998)?