

Written Exam at the Department of Economics winter 2020-21

Behavioral Finance

Final Exam

16-12-2020

(2-hour open book exam)

Answers only in English.

The paper must be uploaded as one PDF document. The PDF document must be named with exam number only (e.g. '127.pdf') and uploaded to Digital Exam.

This exam question consists of 3 pages in total

This exam has been changed from a written Peter Bangsvej exam to a take-home exam with helping aids. Please read the following text carefully in order to avoid exam cheating.

Be careful not to cheat at exams!

You cheat at an exam, if you during the exam:

- Copy other people's texts without making use of quotation marks and source referencing, so that it may appear to be your own text. This also applies to text from old grading instructions.
- Make your exam answers available for other students to use during the exam
- Communicate with or otherwise receive help from other people
- 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
- Use parts of a paper/exam answer that you have submitted before and received a passed grade for without making use of source referencing (self plagiarism)

You can read more about the rules on exam cheating on the study information pages in KUnet and in the common part of the curriculum section 4.12.

Exam cheating is always sanctioned with a warning and dispassion from the exam. In most cases, the student is also expelled from the university for one semester.

Overconfidence

- a) Consider a setting in which an investor's individual demand for a security depends upon her private evaluation of the security. The private evaluation depends on the investor's prior opinion and the market price of the security. Assume that all investors are price takers. Using this setting, formally explain how overconfidence can lead to more trading volume on stock markets / excessive trading. Discuss how the results presented in Glaser and Weber (2007), Overconfidence and Trading Volume, Geneva Risk and Insurance Review, 32(1), 1-36 can be related to this form of overconfidence.
- a) Explain why, in a corporate context, overconfidence creates a relation between investments and firm liquidity. How is this related to the idea of 'market timing'?

Experimental Asset Markets:

- a) Gneezy, Kapteyn & Potters (in Gneezy, Kapteyn & Potters (2003), Evaluation Periods and Asset Prices in a Market Experiment, Journal of Finance, 58(2), 821-837) present an experimental analysis. Below, you find one of the figures that they use to present their results. Please concisely explain the idea of their experiment and the results in the figure. In doing so, please also explain their experimental set-up and how treatments H and L are defined.

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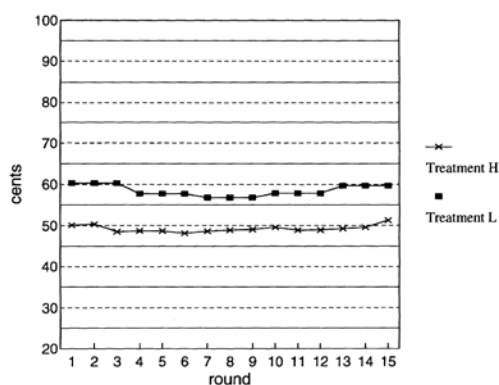


Figure 3. Average prices per round. For each round, asset prices are averaged first over the transactions in a session, then over the five sessions of each treatment.

- b) Explain the relation between their experimental set-up, their results and the equity premium puzzle. In doing so please clearly explain the equity premium puzzle.

Ambiguity Aversion:

- a) One of the prominent psychological explanations for ambiguity aversion is the 'fear of negative evaluations'. Explain what 'fear of negative evaluation' means, and how it is related to ambiguity aversion. In doing so please also explain ambiguity aversion using the Ellsberg Paradox.

- b) Explain in detail how the experimental design presented in Trautmann, Vieider & Wakker (2008), Causes of Ambiguity Aversion: Known Versus Unknown Preferences, Journal of Risk and Uncertainty, 36 , 225-243 allow to test for this explanation of ambiguity aversion?

- c) Briefly explain the reasoning behind Trautmann et al. (2008)'s argument that 'fear of negative evaluation' suggests that the 'Home bias' is a more long term phenomenon in Finance than in Trade. In doing so please explain the 'Home bias'.