Written Exam at the Department of Economics winter 2018-19

Behavioral Finance

Final Exam

18-12-2018

(2-hour closed book exam)

Answers only in English.

This exam question consists of 2 pages in total

NB: 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. Then you leave the examination. When you arrive home, you must contact your GP and submit a medical report to the Faculty of Social Sciences no later than seven (7) 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

Question 1: Myopic Loss Aversion

(1.a) Define `Myopic Loss Aversion' and explain how myopic loss aversion can be one of the reasons for the so called equity premium puzzle.

(1.b) Both, '*Gneezy, Kapteyn & Potters (2003), Evaluation Periods and Asset Prices in a Market Experiment, Journal of Finance, 58(2), 821-837* '

as well as

'Haigh & List (2005), Do Professional Traders Exhibit Myopic Loss Aversion? An Experimental Analysis, The Journal of Finance, 60(1), 523-534'

provide experimental evidence regarding myopic loss aversion. Please explain their experimental set-up and results.

Question 2: Heuristics and Biases

(2.a) Define and explain the representativeness heuristics. Clearly describe a concrete example which shows how the representativeness heuristic can influence financial decisions

(2.b) Use our discussion about the paper by

'Rabin (2002), Inferences by Believers in the Law of Small Numbers, Quarterly Journal of Economics, 117(3), 775-816'

to explain what the law of small numbers is and how it relates to the gamblers' and hot-hand fallacy.

Question 3: Conservatism and Momentum

(3.a) Please explain how conservatism can lead to the momentum effect.

(3.b) In '*Barberis, Shleifer and Vishny (1998), A model of investor sentiment, Journal of Financial Economics, 49, 307-343'* not only evidence for momentum but also evidence for longer term overshooting is cited. Against this background, a model of investor sentiment is presented. Please explain this model and the resulting consequence for asset prices.