Written Exam at the Department of Economics winter 2018-19

Behavioral Finance

Re-exam

18-2-2019

(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: The Disposition Effect

(1a) Please define the disposition effect and explain which elements of prospect theory can explain it and how.

(1b) During the course we talked about the following paper:

Weber & Camerer (1998), The disposition effect in securities trading: an experimental analysis, Journal of Economic Behavior & Organization, Vol. 33, 167-184

Please explain their experimental analysis and their results. How does their setting allow to identify the disposition effect?

Question 2: Behavioral corporate finance

(2a) We talked about two different approaches in the literature on behavioral corporate finance: (a) ‘smart managers and irrational investors’, (b) ‘biased managers and rational investors’. What are these approaches? Define and explain them. In particular explain the three conflicting goals that managers balance in the ‘smart managers and irrational investors’ approach to behavioral corporate finance.

(2b) Explain the analysis and results of

Malmendier & Tate (2005), CEO Overconfidence and Corporate Investment, JFE, 60(6), 2661-2700

Please also indicate to which of the two approaches this analysis belongs.

Question 3: Ambiguity Aversion

(2a) Explain the Ellsberg Paradox and ambiguity aversion. Give an example describing the impact of ambiguity aversion on financial decisions.

(2b) Explain how MaxMin Expected Utility Theory from Gilboa and Schmeidler (1989) can explain the Ellsberg Paradox.