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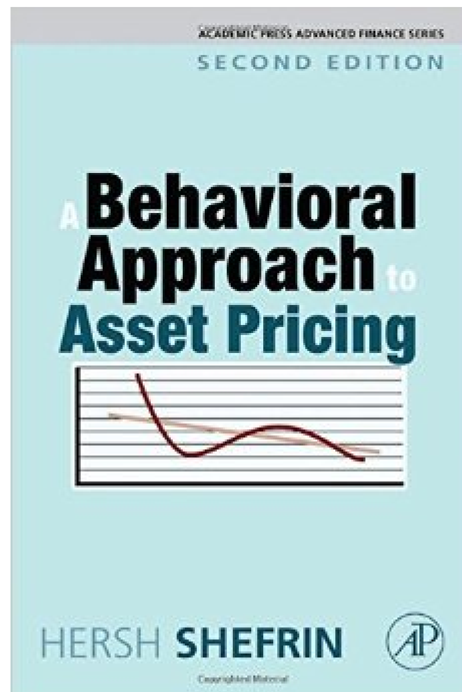
A Behavioral Approach To Asset Pricing, Second Edition (Academic Press Advanced Finance)



Synopsis

Behavioral finance is the study of how psychology affects financial decision making and financial markets. It is increasingly becoming the common way of understanding investor behavior and stock market activity. Incorporating the latest research and theory, Shefrin offers both a strong theory and efficient empirical tools that address derivatives, fixed income securities, mean-variance efficient portfolios, and the market portfolio. The book provides a series of examples to illustrate the theory. A companion website contains these examples worked out as Excel spreadsheets so that readers can input their own data to test the results. * The second edition continues the tradition of the first edition by being the one and only book to focus completely on how behavioral finance principles affect asset pricing, now with its theory deepened and enriched by a plethora of research since the first edition* A companion website contains a series of examples worked out as Excel spreadsheets so that readers can input their own data to test the results

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... In earnest, in Part VII, where Chapters 24-25 discuss prospect theory, Chapters 26-27 explore the "SP/A" theory of Lopes (1989), Chapter 29 addresses the disposition effect, and Chapter 30 reflects on the equity-premium puzzle. Perhaps it’s semantics, but my impression is that "Behavioral approach to asset pricing" is not so much about irrationality as about heterogeneity. The book does start with irrationality - specifically, the representativeness heuristic - to create a class of agents with non-Bayesian probability judgments (maximizing expected utility in a special N-period Arrow-Debreu

world; later on, risk-aversion and rate-of-time-preference differences are explored), but I am not sure that we are interested in such irrationality beyond its ability to produce optimists and pessimists. However novel this contribution is, I suspect that other researchers have explored the subject as well, and more references would help. Known behavioral-finance concepts come up before Part VII - in Chapter 18, for example - but are not integrated into the formal model in the same way. Due to the book's technical/methodological approach, I would not recommend the book to lay readers - this is a book for academics. I cannot competently critique the book to their standard, but the author's standing and the book's breadth definitely make it a must-see.PS. Three side notes:1. Reading Chapters 6-7, which suggest that professional investors are prone to predicting reversals while non-professional ones favor continuation, I notice that the first assertion is based on limited (2 studies) and mixed evidence - contrast "professional investors tend to predict reversals" on page 59 and "professional investors act as trend followers" on page 57.2.

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