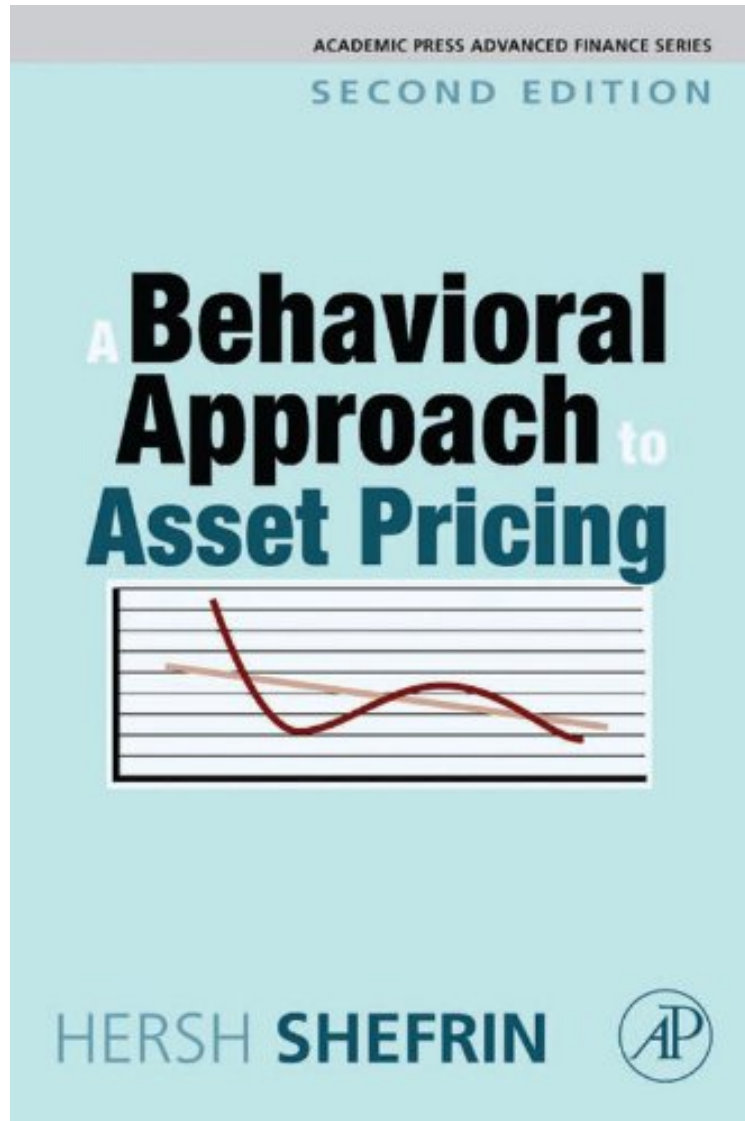


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A Behavioral Approach to Asset Pricing (Academic Press Advanced Finance)

Hersh Shefrin

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Hersh Shefrin : A Behavioral Approach to Asset Pricing (Academic Press Advanced Finance) before purchasing it in order to gauge whether or not it would be worth my time, and all praised A Behavioral Approach to Asset Pricing (Academic Press Advanced Finance):

2 of 2 people found the following review helpful. Where's the bee... havioral?By Dimitri Shvorob... 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. Representativeness incorrectly discounts base rates - how do we fathom those in investing context? Taking fixed unconditional empirical probabilities would probably not be quite satisfactory? 3. On page 40, why does "equilibrium" mean equal consumption by rational and irrational agents?

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. 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 mathematical-economist-turned-behavioral-economist, Hersh Shefrin challenges and delights the reader by applying concepts of behavioral economics with emphasis on investor heterogeneity to revisit a broad spectrum of topics in finance including portfolio management, trading, and the pricing of equities, bonds and options. George M. Constantinides, Leo Melamed Professor of Finance, The University of Chicago Graduate School of Business; The flood of empirical asset pricing research in recent years has often required financial economists to choose between two unpalatable options: either embrace the rich range of evidence with a somewhat atheoretical view; or, simply ignore that large portion of the evidence that conflicts with classical asset pricing theory. The behavioral finance pioneer Hersh Shefrin, in this new edition of his treatise, shows that one need not choose between theory and data. He shows that a number of seemingly "behavioral" patterns in the data can in fact be derived from a suitably modified version of the stochastic discount factor framework. Impressive in both scope and attention to detail, this book will be valuable for researchers, teachers, students, and investment professionals. Jeffrey Wurgler, Research Professor of Finance, NYU Stern School of Business; Judging from the large volume of trade in the financial markets and the astounding volatility of prices, one has to accept the idea that investors hold divergent and fast fluctuating beliefs. For this to make sense, I see only two possible hypotheses. Both individual and professional investors receive a lot of information some of it public but a lot more of it private on which they act. Or they all receive similar information but each one interprets that information somewhat differently from the other. Although it is not quite rational, I find the latter behaviour more plausible than the former. A large part of the second edition of *A Behavioral Approach to Asset Pricing* is devoted to developing this arresting, although by no means mainstream, hypothesis. In that endeavour, Professor Shefrin is a maverick and a pioneer. Bernard Dumas, Professor of Finance, Swiss Finance Institute, Université de Lausanne, Switzerland Praise for the First Edition: "This book provides a much-needed bridge between behavioral finance and traditional asset pricing theory, so that the insights that the two fields offer can complement each other. This book will make the theory of behavioral finance far more useful and broadly applicable. Robert Shiller, Cowles Foundation for Research in Economics, International Center for Finance, Yale University From the Back Cover: "A mathematical-economist-turned-behavioral-economist, Hersh Shefrin challenges and delights the reader by applying concepts of behavioral economics with emphasis on investor heterogeneity to revisit a broad spectrum of topics in finance including portfolio management, trading, and the pricing of equities, bonds and options. George M. Constantinides, Leo Melamed Professor of Finance, The University of Chicago Graduate School of Business; The flood of empirical asset pricing research in recent years has often required financial economists to choose between two unpalatable options: either embrace the rich range of evidence with a somewhat atheoretical view; or, simply ignore that large portion of the evidence that conflicts with classical asset pricing theory. The behavioral finance pioneer Hersh Shefrin, in this new edition of his treatise, shows that one need not choose between theory and data. He shows that a number of seemingly "behavioral" patterns in the data can in fact be derived from a suitably modified version of the stochastic discount factor framework. Impressive in both

scope and attention to detail, this book will be valuable for researchers, teachers, students, and investment professionals. Jeffrey Wurgler, Research Professor of Finance, NYU Stern School of Business "Judging from the large volume of trade in the financial markets and the astounding volatility of prices, one has to accept the idea that investors hold divergent and fast fluctuating beliefs. For this to make sense, I see only two possible hypotheses. Both individual and professional investors receive a lot of information some of it public but a lot more of it private on which they act. Or they all receive similar information but each one interprets that information somewhat differently from the other. Although it is not quite rational, I find the latter behaviour more plausible than the former. A large part of the second edition of *A Behavioral Approach to Asset Pricing* is devoted to developing this arresting, although by no means mainstream, hypothesis. In that endeavour, Professor Shefrin is a maverick and a pioneer. Bernard Dumas, Professor of Finance, Swiss Finance Institute, Universite de Lausanne, Switzerland Praise for the First Edition: "This book provides a much-needed bridge between behavioral finance and traditional asset pricing theory, so that the insights that the two fields offer can complement each other. This book will make the theory of behavioral finance far more useful and broadly applicable. Robert Shiller, Cowles Foundation for Research in Economics, International Center for Finance, Yale University Incorporating the latest theory and empirical research, the second edition of *A Behavioral Approach to Asset Pricing* provides the most up-to-date and comprehensive discussion of how psychology affects market activity. The key message remains: that the future of asset pricing theory lies in bringing together the powerful SDF-based tools adopted by neoclassical asset pricing theorists and the more realistic assumptions adopted by behavioral asset pricing theorists. The most important equation in the first edition is the decomposition of the log-SDF into sentiment and a fundamental component. In the second edition, Shefrin extends the analysis to demonstrate how this equation can be generalized to encompass the combination of behavioral preferences and behavioral beliefs. This generalization provides a unified approach that ties together the main ideas in the book. The book is supported by a companion website, which contains examples worked out as Excel spreadsheets so that readers can input their own data to test the results. Hersh Shefrin is Mario L. Belotti Professor of Finance, Leavey School of Business, Santa Clara University, CA, USA About the Author Hersh Shefrin holds the Mario L. Belotti Chair in the Department of Finance at Santa Clara University's Leavey School of Business. He is a pioneer of behavioral finance, and has worked on behavioral issues for over thirty years. *A Behavioral Approach to Asset Pricing* is the first behavioral treatment of the pricing kernel. His book *Behavioral Corporate Finance* is the first textbook dedicated to the application of behavioral concepts to corporate finance. His book *Beyond Greed and Fear* was the first comprehensive treatment of the field of behavioral finance. A 2003 article appearing in *The American Economic Review* included him among the top fifteen theorists to have influenced empirical work in microeconomics. One of his articles is among the all time top ten papers to be downloaded from SSRN. He holds a Ph.D. from the London School of Economics, and an honorary doctorate from the University of Oulu in Finland.