

Tulane University  
Ph.D. Lectures

Topics in (Behavioral) Empirical Finance

James P. Weston, Rice University  
(713) 348-4480  
[westonj@rice.edu](mailto:westonj@rice.edu)

Course outline: This course is a series of readings/discussion/lectures centered loosely on recent developments in behavioral finance. We will look at both asset pricing and corporate finance topics. Our focus will be on taking a critical look at econometric empirical methods for hypothesis testing. My goal is to get you familiar with the literature in a couple of very active areas, but more importantly to help you develop an empirical toolbox for conducting your own research. As a result, please expect that we are going to spend a lot of time hammering through the empirical details and econometrics of the papers we discuss.

Course requirement: The course grade will be based on participation in class and a term paper. Paper topics must be approved by me and must be at least loosely related to a topic we have covered. Your paper may not be co-authored and should be roughly 15-30 pages. Paper outlines are due on April 11 and we will discuss them in our last meeting. Final papers are due on May 2<sup>nd</sup>.

**First year students:** Your paper will include a thorough review and critique of the literature on your topic (more than you would normally see in a journal article). Also, your paper must include the replication or minor extension of at least one major result in an existing paper using both the data in the original paper and some new data (an extended or updated sample, a different country, etc.)

**Second year students:** Your paper will also include a thorough review and critique of the literature on your topic (more than you would normally see in a journal article). Also, your paper must include a non-trivial extension of an existing work (incorporating a neglected but theoretically important control variable; a substantially different econometric technique, etc.).

Class Schedule and Reading Assignments

This is an interactive seminar/discussion style class and you must come to class prepared to present and discuss each of the required papers. We will cover 3-5 papers in depth for each weekly class session and briefly review some others. On each paper that we review in depth, you are each expected, not just to have read the paper, but to have outlined the literature, the research question, the testable hypothesis, the empirical strategy for testing, the basic set of results, and to have some critiques in mind. Articles with an asterisk (\*) are required.

## Week 1: Idiosyncratic Risk

---

### Session I Idiosyncratic Risk and Asset Prices

1. \*Goyal, Amit, and Pedro Santa-Clara, 2003, Idiosyncratic risk matters! *Journal of Finance* 58, 975-1007.
2. \*Bali, Turan, Nusret Cakici, Xuemin Yan, and Zhe Zhang, 2005. Does idiosyncratic volatility really matter? *Journal of Finance* 60, 905-29.
3. \*Ang, Andrew, Robert J. Hodrick, Yuhang Xing, and Xiaoyan Zhang, 2006, The cross-section of volatility and expected returns, *Journal of Finance* 61, 259-299.
4. \*Pástor, Lubos, and Pietro Veronesi, 2003, Stock valuation and learning about profitability, *Journal of Finance* 58, 1749-1789.
5. Merton, Robert C., 1987, Presidential Address: A simple model of capital market equilibrium with incomplete information, *Journal of Finance* 42, 483-510.
6. Barberis, Nicholas, and Ming Huang, 2001, Mental accounting, loss aversion, and individual stock returns, *Journal of Finance* 56, 1247-1292.
7. Johnson, Timothy C., 2004, Forecast dispersion and the cross section of expected returns, *Journal of Finance* 59, 1957-1978.

### Session II The time series behavior of idiosyncratic risk

1. \*Campbell, John Y., Martin Lettau, Burton G. Malkiel, Yexiao Xu, 2001, Have individual stocks become more volatile? An empirical exploration of idiosyncratic risk, *Journal of Finance* 56, 1-43.
2. \*Brown, Greg, and Nishad Kapadia, 2007, Firm-specific risk and equity market development, *Journal of Financial Economics* 84, 358-388.
3. \*Fink, Jason, Kristin E. Fink, Gustavo Grullon, and James P. Weston, 2007, What drove the increase in idiosyncratic volatility during the internet boom? Working paper, Rice University.
4. \*Brandt, Michael W., Alon Brav, and John R. Graham, 2006, The idiosyncratic volatility puzzle: time trend or speculative episodes? Forthcoming *Review of Financial Studies*.
5. Wei, Steven, and Chu Zhang, 2006, Why did individual stocks become more volatile? *Journal of Business* 79, 259-291.
6. Xu, Yexiao., and Burton Malkiel, 2003, Investigating the behavior of idiosyncratic volatility, *Journal of Business* 76, 613-643.
7. Irvine, Paul J., and Pontiff, J., 2005, Idiosyncratic return volatility, cash flows, and product market competition, Working paper, University of Georgia.

## Week 2: Payout / Repurchases / Propensity

---

### Session I Background and seminal papers

1. \*Allen, Franklin, and Roni Michaely, 2002, Payout policy, in Jarrow, Maksimovic and Ziemba (eds.), *Handbook of Operations Research and Management Science*.
2. \*Grullon, Gustavo, and Roni Michaely, 2002. Dividends, share repurchases, and the substitution hypothesis, *Journal of Finance* 57, 1649-1684.
3. \*Brav, Alon, John R. Graham, Cam Harvey, and Roni Michaely, 2005, Payout policy in the 21st century, *Journal of Financial Economics* 77, 483–527.

### Session II Recent work

1. \*Fama, Eugene, and Ken French, 2001, Disappearing dividends: changing firm characteristics or increasing reluctance to pay? *Journal of Financial Economics* 60, 3-43.
2. \*DeAngelo, Harry, Linda DeAngelo, Douglas J. Skinner, 2004, Are dividends disappearing? Dividend concentration and the consolidation of earnings, *Journal of Financial Economics* 72, 425-456.
3. \*Baker, Malcolm, and Jeff Wurgler, 2002, Appearing and disappearing dividends: The link to catering incentives, *Journal of Financial Economics* 73, 271-288.
4. \*Hoberg, Gerald and N.R. Prabhala, 2007, Disappearing dividends, catering, and risk, Working Paper, University of Maryland (Available at SSRN).
5. \*Grullon, Gustavo, Brad Paye, Shane Underwood, and James Weston, 2007, Has the propensity to pay out declined? Working paper, Rice University, Available at SSRN.
6. DeAngelo, Harry, Linda DeAngelo, and Rene Stulz, 2006, Dividend policy and the earned/contributed capital mix: A test of the life-cycle theory, *Journal of Financial Economics* 81, 227-254.
7. Baker, Malcolm, and Jeff Wurgler, 2004, A catering theory of dividends, *Journal of Finance* 59, 1125-1165.
8. Douglas J. Skinner, 2007, The evolving relation between earnings, dividends, and stock repurchases, Forthcoming, *Journal of Financial Economics*.

## Week 3: Are Stock Returns Predictable?

---

### Session I

1. \*Chapter 7: Campbell, J., Lo, A., MacKinlay, A., 1997, *The Econometrics of Financial Markets*. Princeton University Press, Princeton, NJ.
2. \*Fama, E., and K. French, 1988, Dividend yields and expected stock returns, *Journal of Financial Economics* 22, 3-27.
3. \*Campbell, J., and R. Shiller, 1988, Stock prices, earnings, and expected dividends, *Journal of Finance* 43, 661-676.
4. \*Boudoukh, Jacob, Roni Michaely, Matthew Richardson, and Michael Roberts, 2007, On the importance of measuring payout yield: implications for empirical asset pricing, *Journal of Finance* 62, 877-916.
5. \*Lettau, Martin, and Sydney Ludvigson, 2005, Expected returns and expected dividend growth, *Journal of Financial Economics* 76, 583-626.
6. Kojien and Van Nieuwerburgh (2007) Financial economics, return predictability, and market efficiency, Working paper, New York University Stern School of Business.

### Session II (This literature is so vast, I put together a long list of background articles)

1. \*Ferson, W. E., S. Sarkissian, and T. T. Simin, 2003, Spurious regressions in financial economics? *Journal of Finance* 58, 1393-1414.
2. \*Boudoukh, J., M. Richardson, and R. F. Whitelaw, 2007, The myth of long-horizon predictability, Forthcoming *Review of Financial Studies*.
3. \*Goyal, Amit and Ivo Welch, 2007, A comprehensive look at the empirical performance of equity premium prediction, Forthcoming *Review of Financial Studies*.
4. \*Cochrane, John H., 2006, The dog that did not bark: a defense of return predictability, Forthcoming *Review of Financial Studies* Available at SSRN.
5. \*Stambaugh, Robert F., 1999. Predictive regressions, *Journal of Financial Economics* 54, 375-421.
6. Hodrick, Robert, 1992, Dividend yields and expected stock returns: Alternative procedures for inference and measurement, *Review of Financial Studies*, 5, 257-286.
7. Torous, W., Valkanov, R., Yan, S., 2004. On predicting stock returns with nearly integrated explanatory variables, *Journal of Business* 77, 937-966.
8. Ang Andrew, and Geert Bekaert, 2007, Stock Return Predictability: Is it There? *Review of Financial Studies* 20, 651-707.
9. Bansal, Ravi and Amir Yaron The Asset Pricing-Macro Nexus and Return-Cash Flow Predictability, Working Paper, Wharton.
10. Campbell, J., 1991, A Variance Decomposition of Stock Returns, *Economic Journal* 101, 157-179.

11. Campbell, John H., and Robert Shiller, 1987, Cointegration and tests of present value models, *Journal of Political Economy* 95, 1062-1087.
12. Cochrane, John H., 1991, Volatility tests and efficient markets, *Journal of Monetary Economics*, 27, 463-485.
13. Cochrane John, 1991, Explaining the variance of price-dividend ratios, *Review of Financial Studies* 5:2, 243-280.
14. Fama, E., and K. French, 1988, Permanent and Temporary Components of Stock Prices, *Journal of Political Economy*, 96, 246-273.
15. Fama, E., and K. French, 1989, Business Conditions and Expected Returns on Stocks and Bonds, *Journal of Financial Economics* 25, 23-49.
16. Lustig Hanno and Stijn Van Nieuwerburgh. The Returns on Human Capital: Good News on Wall Street is Bad News on Main Street. Working Paper, NYU and UCLA.
17. Lettau, Martin and Stijn Van Nieuwerburgh, 2006, Reconciling the return predictability evidence, *Review of Financial Studies*, forthcoming.
18. Lamont, Owen, 1998, Earnings and expected returns, *Journal of Finance* 53, 1563 - 1587.
19. LeRoy, Stephen, and Richard Porter, 1981, The present value relation: Tests based on implied variance bounds, *Econometrica* 49, 555-574.
20. Lettau, M, and S. Ludvigson, 2001, Consumption, aggregate wealth, and expected stock returns, *Journal of Finance* 56, 815 - 850.
21. Lewellen, Jonathan W., 2004, Predicting returns with financial ratios, *Journal of Financial Economics*, 74 (2), 209-235.
22. Lo, A., 1991, Long term memory in stock market prices, *Econometrica* 59, 1279-1313.
23. Lo, Andrew W., and A. Craig MacKinlay, 1990, Data-snooping biases in tests of financial asset pricing models, *Review of Financial Studies*, 3, 431 - 468.
24. Poterba, J., and L. Summers, 1988, Mean reversion in stock returns: evidence and implications, *Journal of Financial Economics* 22, 27-60.

## Week 4: Market Timing and Capital Structure

### Session I Market Timing and Capital Structure

1. \*Baker, Malcolm, and Jeffrey Wurgler, 2002, Market timing and capital structure, *Journal of Finance* 57, 1–30.
2. \*Welch, Ivo, 2004, Capital structure and stock returns, *Journal of Political Economy* 112, 106–131.
3. \*Kayhan, Ayla, and Sheridan Titman, 2007, Firms' histories and their capital structure, *Journal of Financial Economics* 83, 1-32.
4. \*Leary, Mark T., and Michael R. Roberts, 2005, Do firms rebalance their capital structure? *Journal of Finance* 60, 2575–2619.
5. \*Lemmon, Michael L., Michael R. Roberts, and Jaime F. Zender, 2006, Back to the beginning: Persistence and the cross-section of corporate capital structure, working paper, <http://ssrn.com/abstract=881899>.
6. Alti, Aydogan, 2006, How Persistent is the impact of market timing on capital structure? *Journal of Finance* 61, 1681-1710.
7. Hennessy, Christopher A., and Toni M. Whited, 2005, Debt dynamics, *Journal of Finance* 60, 1129–1165.
8. Huang, R., Ritter, J., 2004. Testing the market timing theory of capital structure. Working paper, University of Florida.

### Session II Managerial market timing debate

1. \*Schultz, Paul, 2003, Pseudo market timing and the long-run underperformance of IPOs, *Journal of Finance* 58, 483-517.
2. \*Baker, Malcolm, and Jeffrey Wurgler, 2000, The equity share in new issues and aggregate stock returns, *Journal of Finance* 55, 2219-2257.
3. \*Butler, A.W., Grullon, G., Weston, J.P., 2005, Can managers forecast aggregate market returns? *Journal of Finance* 60, 963-986.
4. \*Baker, Malcolm, Robin Greenwood, and Jeffrey Wurgler, 2003, The maturity of debt issues and predictable variation in bond returns, *Journal of Financial Economics*, 70, 261-289.
5. \*Baker, M., R. Taliaferro, and J. Wurgler, 2006, Predicting returns with managerial decision variables: is there a small-sample bias? *Journal of Finance*, 61, 1711-1729.
6. \*Butler, A. W., G. Grullon, and J. P. Weston, 2006, Can managers successfully time the maturity structure of their debt issues? *Journal of Finance* 61, 1731-1758.

## Week 5: Investor attention / The role of the media in stock prices

### Session I

1. \*Huberman, Gur, and T. Regev, 2001, Contagious speculation and a cure for cancer: a non-event that made stock prices soar, *Journal of Finance* 56, 387–396.
2. \*Gervais, Simon, Ron Kaniel, and Dan H. Mingelgrin, 2001, The high-volume return premium, *Journal of Finance* 56, 877-919.
3. \*Grullon, Gustavo, George Kanatas, and James P. Weston, 2004, Advertising, breath of ownership, and liquidity, *Review of Financial Studies* 17, 439-461.
4. \*Gabaix, Xavier, David I. Laibson, Guillermo Moloche, and Stephen Weinberg, 2003, The Allocation of Attention: Theory and Evidence, MIT Department of Economics Working Paper No. 03-31. Available at SSRN: <http://ssrn.com/abstract=444840>.
5. \*Peng, Lin and Wei Xiong, 2006, Investor Attention, Overconfidence and Category Learning, *Journal of Financial Economics* 80, 563-602.
6. Barber, Brad, and Terry Odean, 2003, All that glitters: the effect of attention and news on the buying behavior of individual and institutional investors. Unpublished working paper. University of California, Davis and University of California, Berkeley.

### Session II

1. \*Chan, Wesley, 2003, Stock price reaction to news and no-news: drift and reversal after headlines, *Journal of Financial Economics*, 223-260.
2. \*Antweiler, Werner, and Murray Z. Frank, 2004, Is all that talk just noise? The information content of internet stock message boards, *Journal of Finance* 59, 1259-1293.
3. \*Tetlock, Paul C., 2007, Giving content to investor sentiment: The role of media in the stock market, *Journal of Finance* 62 1139-1168.
4. \*Engelberg, Joseph, Caroline Sasseville, and Jared Williams, 2007, Attention and Asset Prices: the Case of Mad Money, Working paper, available at SSRN: <http://ssrn.com/abstract=870498>.
5. Hirshleifer, David, Sonya S. Lim, and Siew Hong Teoh, 2007, Driven to Distraction: Extraneous Events and Underreaction to Earnings News, Working paper on SSRN.
6. Fang, Lily H. and Peress, Joel, 2007, Media Coverage and the Cross-Section of Stock Returns, Working paper on SSRN.