

Asset Pricing: Theory and Experiments

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Time & Place:

Monday, 19th May 2014 at 14:00-17:00 hs, at room PLD E - 06 (Plattenstr. 32, ground floor)

Tuesday, 20th May 2014 at 14:00 - 17:00 hs, at room PLD E - 06 (Plattenstr. 32, ground floor)

Tuesday, 17th June 2014 at 14:00 - 17:00 hs at room PLD E - 06 (Plattenstr. 32, ground floor)

The goal of this mini-course is twofold. First, it seeks to offer a simple exposition of the key insights of the theory of asset pricing in complete and perfect markets. Second, it seeks to confront the implications from this theory to experimental data. To do so, the three lectures will combine theoretical discussions, live experimental financial markets and presentations of experimental results.

Lecture 1: During the first lecture, students will participate in an experimental financial market, where they will have the opportunity to buy or sell a risky asset. To ensure that participants seriously engage in the experiment, they will receive financial compensation based on their trading gains. Depending on the realization of his/her trading gains, a participant will earn between 50 and 150 Swiss Francs. Pedagogically, the aim is that participating in this experimental financial market will help students gain personal insights and intuition into the underlying forces driving market equilibrium.

Lecture 2: During this lecture, I will present a simple model to highlight the key insights of the theory of asset pricing in complete and perfect markets. Self-contained lecture notes will be provided.

If, in addition, students wish to use textbooks, I recommend

- Demange and Laroque (2006), especially the fifth section, entitled "Optimal risk sharing and insurance" of Chapter 2 entitled "Exchanging Risk", as well as
- Huang and Litzenberger (1988), especially Chapter 5, entitled "Allocative efficiency and the valuation of state contingent securities".

The main original research pieces underlying this lecture are the following:

- Arrow, K., (1964). "The Role of Securities in the Optimal Allocation of Risk-bearing," Review of Economic Studies 31 (2): 91-96.
- Borch, K., (1962). "Equilibrium in a reinsurance market", Econometrica, 30 (3) 424-444.
- Debreu, G. (1959). The Theory of Value: An axiomatic analysis of economic equilibrium.
- Lucas, R. E. (1978). "Asset prices in an exchange economy", Econometrica, 46 (6) 1429-1435.

Lecture 3: During this lecture I will present experimental results from several recent research papers, confronting the predictions of the theory to experimental data. The main references for this lecture are the following:

- Biais, B., S. Moinas, S. Pouget and T. Mariotti, 2014. "Asset pricing and risk-sharing in an experimental financial market." Working paper. Toulouse School of Economics.
- Bossaerts, P. & C. Plott, 2004. "Basic Principles of Asset Pricing Theory: Evidence from Large-Scale Experimental Financial Markets." Review of Finance. 8(2), 135-169.
- Bossaerts, P., C. Plott and W. Zame, 2007. "Prices and Portfolio Choices in Financial Markets: Theory, Econometrics, Experiments." Econometrica. 75(4), 993-1038.