Course Overview and Objectives

This course provides an introduction to selected topics and methods in empirical finance that focus on asset pricing and return predictability. We begin with an introduction to basic ideas about asset pricing leading to the stochastic discount factor and expected return-beta representations. Next, we provide an overview of selected econometric techniques used for empirical tests of asset pricing models. If time permits, we will also cover some prominent multifactor models and consumption-based models proposed in the literature. We then provide a brief overview about efficient markets and the “stylized facts” about asset returns that theory seeks to explain. Next, we introduce the event study methodology that has wide applications in finance and economics. Finally, we cover some selected aspects from the literature on stock return predictability. The course concludes with presentations by students of recent research on topics covered in the course. An overview of the framework that ties together the topics in this course is Campbell (2015).


The Basic Pricing Equation & Classic Issues in Finance
Risk Corrections & Expected Return-Beta Representation
The Equity Premium Puzzle
Consumption-based and Multifactor Models in Finance
Unconditional and Conditional Models (if time permits)

Ch. 1 & 2 excluding Asset Pricing in Continuous-Time i.e. 1.8, 1.8.1, 1.8.2.
Ch. 4: 4.1, 4.2, 4.3, 4.4. Ch. 5: 5.1, 5.2, 5.2.1, 5.2.2, Ch. 6, 8, 9.


Ch. 10, 11, 12, 13.


We will look at stylized facts of equity markets and recent research on “anomalies” like the value-growth and momentum puzzles. We then turn to basic ideas about the Efficient Markets Hypothesis and the event study methodology.

Main References:

Event Studies:
Textbook Chapter: Overview of this huge area and its relation with the practical world:
Bodie, Zvi, Alex Kane and Alan Markus, Investments, 9th Edition on “The Efficient Market Hypothesis”
or similar chapter in earlier Editions.

4. Present Value Models and Return Predictability.

Present Value Models in Finance

Review of selected recent work on stock return predictability.

Chapter 7, Campbell, J. A. Lo, and A. Craig Mackinlay (1997), Econometrics of Financial Markets,
Princeton University Press.

Assessment

This will be based on an Individual Take Home assignment - full details will be provided at the start of the

General References

Course materials will include lecture notes/slides, review papers and selected recent papers in empirical
asset pricing.

Textbooks

The course will rely mainly on Cochrane (2005). However, CLM has some nice material on empirical tests
of asset pricing models and on Campbell-Shiller decomposition etc. Pennachi is a nice modern survey of
the theoretical foundations of asset pricing. There are excellent Notes available on Prof. John Cochrane’s
website. For those with an interest in asset pricing – there is no better place than the Coursera course – free
on the web- by Prof John Cochrane.

Cochrane, J., 2005, Asset Pricing, Princeton University Press,

Survey Papers

These are several excellent surveys of the work on empirical asset pricing and predictability. Copies for
individual use are available in some cases on the author’s websites.

7, 35–83.

Breeden D. T.,1 R. H. Litzenberger and T. Jia, 2015, Consumption-Based Asset Pricing, Part 2: Habit
Formation, Conditional Risks, Long-Run Risks, and Rare Disasters, Annual Review of Financial
Economics, 7, 85–131.


Cochrane, J, 2005, Financial Markets and the Real Economy, draft Chapter 7, Handbook of the Equity Risk
Premium. (FMRE)


and

Bank of America-Meryll Lynch, The Longest EquityPictures

Note: This is not an econometrics course and so some familiarity with the basic ideas of OLS/GLS regressions, ML, Large Sample/Finite Sample Inference, Wald/LM and LR tests and GMM estimation etc at the level of Greene, Hamilton or Hayashi will be assumed. An intuitive and clear exposition of basic ideas is: Wooldridge, J, Introductory Econometrics, (any Recent Edition), Cengage Learning Custom Publishing.