Department of Finance
McCombs School of Business, University of Texas at Austin

Finance 395-3 # 03700

ASSET PRICING THEORY

Spring 2016

Monday & Wednesday at 9:30-11:00am in CBA 4.338

People

Instructor
Jan Schneider
jan.schneider@mccombs.utexas.edu
CBA 6.222

Content

This course covers asset pricing theory from the classic foundations up to current research. Classic topics include state prices, pricing kernels, mean-variance efficient portfolios, arbitrage pricing theory, expected utility, risk aversion, representative agent and asymmetric information. We will focus mostly on multiperiod discrete time models but also cover the basics of continuous time (mostly ICAPM). More current topics center around consumption-based asset pricing with applications to cross-sectional returns (for example the value premium) and the time series of the market return (for example equity premium and time series predictability). This class focuses on theory but we will also discuss some empirical findings to better understand what theory needs to explain.

Textbook

There is no required textbook for this class. If you would like to do any additional reading, here is a list of useful books:

- Beck, Kerry E., Asset pricing and portfolio theory, *Oxford University Press*
- Cochrane, John H., 2005, Asset pricing, *Princeton University Press*
- Skiadas, Costis, 2009, Asset pricing theory, *Princeton University Press*
- Duffie, Darrel, 2001, Dynamic asset pricing theory, *Princeton University Press*

Class Notes

http://www.janschneider.website/teaching/asset_pricing.html

Requirements

Classroom presentations count 50% towards your grade.
We will have a mid-term and a final exam. Each exam counts 25% towards your grade.

Tentative List of Papers

1. Markowitz, Harry, 1952, Portfolio selection, *Journal of Finance*, 7, 77-91
2. Tobin, James, 1958, Liquidity preference as behavior towards risk, *Review of Economic Studies*, 25, 65-86
3. Pratt, John W., 1964, Risk aversion in the small and large, *Econometrica*, 32, 122-136.
4. Sharpe, William, 1964, Capital asset prices: a theory of market equilibrium under conditions of risk, *Journal of Finance*, 19, 425-442
5. Lintner, John, 1965, The valuation of risky assets and the selection of risky investments in stock portfolios and capital budgets, *Review of economics and statistics*, 47, 13-37
6. Merton, Robert C., 1973, An intertemporal capitl asset pricing model, *Econometrica*, 41, 867-887
7. Rubinstein, Mark, 1974, An aggregation theorem for securities markets, *Journal of financial economics*, 1, 225-244
8. Lucas, Robert E., 1978, Asset prices in an exchange economy, *Econometrica*, 46, 1429-1445
9. Kahneman, Daniel, and Amos Tversky, Prospect theory: an analysis of decision under risk, *Econometrica*, 47, 263-292
10. Grossman, Sanford J., and Joseph E. Stiglitz, 1980, On the impossibility of informationally efficient markets, *American Economic Review*, 70, 393-408
11. Shiller, Robert J., 1981, Do stock prices move too much to be justified by subsequent changes in dividends?, *America Economic Review*, 71, 421-436

12. Hansen, Lars Peter, and Kenneth J. Singleton, 1983, Stochastic consumption, risk aversion, and the temporal behavior of asset returns, *Journal of Political Economy*, 91, 249-265

13. Kyle, Albert S., 1985, Continuous auctions and insider trading, *Econometrica*, 53, 1315-1335

14. Mehra, Rajnish, and Edward C. Prescott, 1985, The equity premium - a puzzle, *Journal of Monetary Economics*, 15, 145 - 161

15. Rietz, Thomas A., 1988, The equity premium - a solution, *Journal of Monetary Economics*, 22, 117-131

16. Mehra, Rajnish, and Edward C. Prescott, 1988, The equity premium: a solution?, *Journal of Monetary Economics*, 22, 133-136

17. Campbell, John Y., and Robert J. Shiller, 1988, The dividend-price ratio and expectations of future dividends and discount factors, *Review of Financial Studies*, 1, 195-228

18. Epstein, Larry G., and Stanley E. Zin, 1989, Substitution, risk aversion, and the temporal behavior of consumption and asset returns: a theoretical framework, *Econometrica*, 57, 937-969.

19. Backus, David K., Gregory, Allan W., and Stanley Zin, 1989, Risk premiums in the term structure - evidence from artificial economies, *Journal of Monetary Economics*, 24, 371-399

20. Weil, Philippe, 1989, The equity premium puzzle and the risk-free rate puzzle, *Journal of Monetary Economics*, 24, 401-421

21. Gul, Faruk, 1991, A theory of disappointment aversion, *Econometrica*, 59, 667-686

22. Hansen, Lars Peter, and Ravi Jagannathan, 1991, Implications of security markets data for models of dynamic economies, *Journal of political economy*, 99, 225-262

23. Fama, F. Eugene, and Kenneth R. French, 1993, Common risk factors in the returns on stocks and bonds, *Journal of Financial Economics*, 33, 3-56

24. Fama, F. Eugene, and Kenneth R. French, 1996, Multifactor explanations of asset pricing anomalies, *Journal of Finance*, 51, 55-84

25. Jagannathan Ravi, and Zhenyu Wang, 1996, The conditional CAPM and the cross-section of expected returns, *Journal of Finance*, 51, 3-53

26. Constantinides, George M., and Darrel Duffie, 1996, Asset prices with heterogeneous consumers, *Journal of Political Economy*, 104, 219-240

27. Heaton, John, and Debora J. Lucas, 1996, Evaluating the effects of incomplete markets on risk sharing and asset pricing, *Journal of Political Economy*, 104, 443-487

28. Jerman, Urban J, 1998, Asset pricing in production economies, *Journal of Monetary Economics*, 41, 257-275

29. Campbell, John Y., and John H. Cochrane, 1999, By force of habit: a consumption-based explanation of aggregate stock market behavior, *Journal of Political Economy*, 107, 205-251

30. Berk, Jonathan B., and Richard C. Green, 1999, Optimal investment, growth options, and security returns, *Journal of Finance*, 54, 1553-1607

31. Heaton, John, and Deborah Lucas, 2000, Portfolio choice and asset prices: the importance of entrepreneurial risk, *Journal of Finance*, 55, 1163-1198

32. Lettau, Martin, and Sydney Ludvigson, 2001, Consumption, aggregate wealth, and expected stock returns, *Journal of Finance*, 56, 815-849

33. Brav, Alon, Constantinides, George M., and Christopher C. Greczy, 2002, Asset pricing with heterogeneous consumers and limited participation: empirical evidence, *Journal of Political Economy*, 110, 793-824

34. Bansal, Ravi, and Amir Yaron, 2004, Risks for the long run: a potential resolution of asset pricing puzzles, *Journal of Finance*, 59, 1481-1509

35. Parker, Jonathan A., and Christian Julliard, 2005, Consumption risk and the cross section of expected returns, *Journal of Political Economy*, 115, 185-222

36. Yogo, Motohiro, 2006, A consumption-based explanation of expected stock returns, *Journal of Finance*, 2006, 539-580

37. Wachter, Jessica, 2006, A consumption-based model of the term structure of interest rates, *Journal of Financial Economics*, 79, 365-399

38. Barro, Robert J., 2006, Rare disasters and asset markets in the twentieth century, *Quarterly Journal of Economics*, 121, 823-866

39. Lewellen, Jonathan, and Stefan Nagel, 2006, The conditional CAPM does not explain asset pricing anomalies, *Journal of Financial Economics*, 82, 289-314

40. Piazzezi, Monika, Schneider, Martin, and Selale Tuzel, 2007, Housing, consumption and asset pricing, *Journal of Financial Economics*, 83, 537-569

41. Jagannathan, Ravi, and Yong Wang, 2007, Lazy investors, discretionary consumption, and the cross-section of stock returns, *Journal of Finance*, 62, 1623-1661

42. Hansen, Lars Peter, Heaton, John C, and Nan Li, 2008, Consumption strikes back? measuring long-run risk, *Journal of Political Economy*, 116, 260-302

43. Cochrane, John H., Longstaff, Francis A., and Pedro Santa-Clara, 2008, Two trees, *Review of Financial Studies*, 21, 347-385

44. Lochstoer, Lars A, 2009, Expected returns and the business cycle: Heterogeneous goods and time-varying risk aversion, *Review of Financial Studies*, 22, 5251-5294

45. Malloy, Christopher J., Moskowith, Tobias J, and Annette Vissing-Jorgensen, 2009, Long-run stockholder consumption risk and asset returns, *Journal of Finance*, 64, 2427-2479

46. Routledge, Bryan R., and Stanley E. Zin, 2010, Generalized disappointment aversion and asset prices, *Journal of Finance*, 65, 1303-1332

47. Chien, YiLi, and Hanno Lustig, 2010, The market price of aggregate risk and the wealth distribution, *Review of Financial Studies*, 23, 1596-1650