Corporate Finance, Module 11, "Efficient Markets and Behavioral Finance"

Readings for the Fourteenth Edition (2022) of the Brealey, Myers, Allen, and Edmans text

(The attached PDF file has better formatting.)

The sections in this posting are for the *fourteenth* edition of the Brealey, Myers, Allen, and Edmans text. You may also use the seventh through thirteenth editions; final exam problems can be answered from any edition.

{The Brealey, Myers, Allen, and Edmans textbook is excellent. We say to read certain sections and to skip others. This does not mean that certain sections are better; it means that the homework assignments and exam problems are based on the sections that you must read for this course. Some of the skipped sections are fascinating, but they are not tested.}

Read section 12.1, "Differences between Investment and Financing Decisions." The central theme of this chapter is that financial markets are much more competitive than product markets so the NPV of financing decisions is zero in efficient markets.

Read section 12.2, "The efficient market hypothesis." The textbook compares two definitions of efficient markets (formulas 12.1 and 12.2) and three forms of market efficiency. A final exam problem may give a scenario and ask whether it supports or rejects a particular forms of market efficiency.

Read section 12-3 "Implications of Market Efficiency." Final exam problems test random walks and abnormal returns; see the practice problems on the discussion forum.

Read section 12-4 "Are Markets Efficient? The Evidence." The textbook gives a balanced perspective.

Skip section 12-5 "Behavioral Finance." The behavioral psychology insights are important, but their predictive value is nil. Managers, investors, and traders have preferences and faults, but we have no way to estimate values based on these behaviors.

Review end of chapter problems 1, 2, 3, 4, 9, 10, 11, 12, 13, 15.

Illustrative test questions, problems, and homework assignments are shown separately on the discussion forum.