Summary
This course provides an overview of the theory of asset pricing and portfolio choice theory following historical developments in the field and putting emphasis on theoretical models that help our understanding of financial decision making and financial markets.

Content
We start with the standard stochastic discount factor framework of Breeden-Lucas-Rubinstein. We then review the main stylized facts that have challenged the classic model in the last thirty years: equity premium puzzle, excess volatility puzzle, cross-sectional (value, growth, momentum) puzzles. We investigate several extensions of the classic framework that financial economists have proposed to explain these facts. First, we cover new preferences: recursive utility, habit formation, uncertainty aversion. Then, we investigate incomplete markets, trading frictions, and heterogeneous agent models. Finally, we investigate limits to arbitrage theories combined with behavioral explanations such as heterogeneous beliefs, bounded rationality, and other deviations from rationality proposed in the recent literature. A last section covers recent attempts to model liquidity risk.

Assessment methods
Written exam.

Resources
Websites
• http://sfi.epfl.ch/collindufresne