

Economics 225: Financial Markets & Investments
Fall 2007
RH 203, T-Th 3:15-4:30pm

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Office Hours: Tues. 5-6:30 & Wed 1-3
and by appointment

Overview

This class is designed to give students exposure to the most fundamental elements of the field of finance. We will examine the different types of financial assets, how to calculate and compare their returns, the markets in which they trade, the optimal way to combine them, and the determination of their prices. We will also discuss several fundamental concepts, such as the relationship between risk and return, the principal-agent problem in financial markets, and the Efficient Markets Hypothesis. Emphasis will be placed on the real world applications of the material presented in class, as the knowledge obtained will be helpful beyond the course itself. The aim is to provide tools that will help students make more informed financial decisions, in both professional and personal contexts.

Prerequisites

While there are no formal prerequisites listed in the course catalogue, this course will use some calculus and basic statistics, so a course such as Econ 209 is strongly recommended.

Textbooks/Readings

The main text for this course is the 6th edition of Essentials of Investments by Zvi Bodie, Alex Kane and Alan J. Marcus.

The supplementary text for the course is The Wall Street Journal Guide to Money and Investing by Kenneth Morris. This book is an excellent reference guide that should serve you well not only during the class but well beyond.

I will also hand out supplementary pages from the 6th edition of Investments by Bodie, Kane and Marcus. This is a more advanced textbook than the one we are using in class, but provides a more thorough discussion of portfolio theory. Finally, I will hand out readings from newspapers and magazines. These are designed to give real world examples and reinforce the relevance of the material from class.

Requirements:

In order to be as fair and impartial as possible I base grades on students' knowledge and understanding of the material as demonstrated in problem sets and exams completed during the course. There will be no opportunities for extra credit. If at any point during the semester you face circumstances which prevent you from attending lecture and completing problem sets and/or exams on time and to the best of your ability, please contact or see me as soon as possible to discuss ways to manage the situation.

Breakdown of the Final Grade is as follows:

Problem Sets	30%
Midterm	30%
Final Exam	40%

You are accountable for material presented in class. I encourage to you get to know someone else in the class, so that if you are unable to attend one or several lectures you can copy the notes. My notes will not be made available.

Problem Sets

There will be seven problem sets during the course. You will be allowed to drop the lowest problem set grade at the end of the semester. The problem sets are designed for you to work through the material yourselves and gain a better understanding of the concepts presented in lecture. I view this as an important part of the learning process and thus the problem sets, combined, account for 30% of the total grade.

Problem sets will be handed back with typed solutions the class after you turn them in. The policy for late problem sets is:

- Same day after class: 1/3 off
- Any later: No Credit

No exceptions will be made for late problem sets (unless, of course, there is an emergency). If you cannot make it to class to turn in your problem set please leave it in my mailbox in the economics department office or leave it under the door of my office. The economics office is open until 3:30 pm. You can also email problem sets to me.

Exams

There will be two exams, a midterm and a final. The midterm will account for 30% of the final grade and the final will account for 40% of the final grade.

Make-up Exams

A student will be eligible to take a make-up exam only if (1) the student is absent from the original exam because of one of the legitimate causes listed in the Undergraduate Catalog and (2) furnishes documentary support for the assertion that the absence resulted from one of these causes. When a make-up exam is warranted, the student is to notify me without any delay.

If a student also misses the make-up exam, then the weight that would have been given to that exam will be assigned to the weight used for that student's final exam. If you fail to take one of the exams and are not eligible for a make-up exam, you will receive a zero score. You cannot choose to have the other exam weighted more heavily in order to adjust for the missed exam.

Course Outline

1. Introduction to Financial Markets

<u>Dates</u>	<u>Topic</u>	<u>Reading</u>
8/30	Introduction to Financial Markets	BKM Ch.1 <i>The Economist</i> "Caveat Investor"
9/4	Financial Instruments	BKM Ch.2, pg.27-42 S&P 32-42 Handout Math Review Notes
9/6	Financial Instruments, including securitization	Handout Financial Market Notes <i>The Economist</i> "Surviving Global Markets"
9/11	Markets and Stock and Bond Indexes <i>(notes will be made available)</i>	BKM Ch.2, pg. 42-49 S&P 94-101
9/13	Buying on Margin and Short Selling	BKM Ch.3, pg. 80-85 S&P 62-65
9/18	Principal-agent Problems & Crisis in Corporate Governance	BKM Ch.1, pg.8-12 S&P 38-39 (voting rules) Supplemental Reading
9/20	Mutual Funds and Other Investment Companies	BKM Ch. 4 S&P 102-109, 116-133

2. Risk Return Tradeoffs and Modern Portfolio Theory

9/25	Risk Return Tradeoff and Interest Rates	BKM Ch.5 Supplemental Pages <u>Investments</u>
9/27	Risk aversion and risk premia	BKM Ch.5 Supplemental Pages <u>Investments</u>
10/2	Portfolio Risk and Hedging	BKM Ch.5 Supplemental pages <u>Investments</u>
10/4	NO CLASS	
10/9	Optimal Total Portfolio	BKM Ch.5, 2 nd half Supplemental pages <u>Investments</u>
10/11	Diversification & the Optimal Risky Portfolio	BKM Ch.6
10/16-18	NO CLASS FALL BREAK	
10/23	Optimal Risky Portfolio	BKM Ch.6

10/25	CAPM	BKM Ch.7
10/30	MIDTERM	
11/1	CAPM & APT Models	BKM Ch.7
3. Security Analysis		
11/6	Bond Pricing	BKM Ch.9
11/8	Bond Pricing (including discussion of credit derivatives)	BKM Ch.9 S&P 68-93
11/13	Term Structure of Interest Rates	BKM Ch.9
11/15	Equity Valuation Models	BKM Ch.12 S&P 46-61
11/20	Equity Valuation Models	BKM Ch.12
11/27	Efficient Markets Hypothesis	BKM Ch. 8
4. Derivatives		
11/29	Options	BKM Ch.14 S&P 138-157
12/4	Options	BKM Ch.15
12/6	Futures	BKM Ch.16 S&P 158-175