

Department of Economics 2011 Fall

ECO358H1F
Financial Economics I
Section L5101
University of Toronto
Department of Economics

Instructor: Ding Ding
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Office Hours: Mondays 15:00-17:00, Thursdays 10:00-11:00, or by appointment
Website: Blackboard (<http://portal.utoronto.ca>)

Prerequisite: ECO200Y/204Y/206Y, ECO220Y/227Y/STA (247H, 248H)/ (250H, 255H)/ (257H, 261H)

Exclusion: ACT349H1, MGT331Y1, 337Y1, RSM332H

Prerequisites are strictly checked and enforced and must be completed before taking a course. By taking this course you acknowledge that you will be removed from the course at anytime if you do not meet all requirements set by the Department of Economics. For further information you can consult the University of Toronto Faculty of Arts and Science 2011-2012 Academic Calendar, which is available from the Registrars' Office.

Course Description

The aim of this course is to provide an overview of the major theories, tools and results in Portfolio Theory and Asset Pricing. Some institutional perspectives of financial markets are introduced, and the theoretical concept and applicable empirical tools are emphasized. Topics to be covered include: Valuation of Fixed Income Securities, Expected Utility and Portfolio Choice, the major models of Asset Pricing (CAPM, APT), Efficient Capital Market, and Option Pricing Theory. As time is limited, we will mainly discuss theoretical issues, but we will also apply the ideas to understand some real-world examples.

Textbooks and Other References

The main textbook for the course is *Investments, 7th Canadian Edition* by Bodie, Kane, Marcus, Perrakis and Ryan (2008, McGraw-Hill Ryerson, hereafter referred to as BKMPR). Students who purchase this book will have access to an on-line learning centre maintained to supplement it. Two other references are recommended: one is *Financial Theory and Corporate Policy, 4th Edition* by Copeland, Weston and Shastri (2005, Pearson Addison Wesley, hereafter referred to as CWS), the other is *Corporate Finance, 5th Canadian Edition* by Ross, Westerfield, Jaffe and Roberts (2008, McGraw-Hill Ryerson, hereafter referred to as RWJR).

Exams

There are two midterm exams and one final exam. Both midterms are two hours long and will be written during class time. The first Midterm will take place on October 19, 2011 (Week 6) at TBA; the second will take place on November 16, 2011 (Week 10) at TBA. The final is a three-hour exam.

Grade Composition

There will be three exams, two midterms and a final. Your course-grade is composed as follows:

$$\begin{aligned} & 40\% \times \text{final} \\ & + 30\% \times \max \{\text{midterm I, midterm II}\} \\ & + 30\% \times \max \{\text{final, min}\{\text{midterm I, midterm II}\}\}. \end{aligned}$$

subject to the provision that the max rule applies only if you achieve a grade of at least 30% in both midterm exams. If you do achieve a grade below 30% in either of the midterms, then both midterm marks count for 30% each. This implies in particular that you cannot discard one of the midterm exams by submitting an empty exam script. As such, your final counts at least 40%; your better midterm counts 30%, and your worse midterm counts 30% only if it is better than the final. In other words, you may pass the weight of your worst midterm to the final, but one midterm will count.

There are no “make-up” tests.

Procedures and Rules

Missing a Midterm. The Midterms are compulsory. If you miss a midterm, their 30% weight in the course grade will only be shifted towards the final if you have a legitimate medical excuse as outlined in the university policies.

In the event a student misses midterm test due to illness or domestic tragedy, the student must submit a doctor’s note or the university’s official “Student Medical Certificate” (available online at <http://www.healthservice.utoronto.ca/pdfs/medcert.htm>) indicating the type of illness and date of illness (or other applicable documentation for domestic situation) within *48 hours of the test date*.

Re-grading. If you appeal to re-grade one or more questions on the midterm test, you have to request in writing and outline in detail why you think that you deserve a higher mark. The entire midterm will be re-marked. Note that this may lead to a lower overall grade.

Email Communication. I will use the email system frequently to send out information, such as announcements about office hours etc. I will use Blackboard to compile the email distribution list from your entries in ROSI. It is thus imperative that you update your email-address on ROSI ASAP. Please check also the Blackboard system frequently for up-to-date information.

I will reply to legitimate email inquiries from students within two working days. If you do not receive a reply within this period, resubmit your question(s). I will NOT answer emails in the last **24 hours** before a test. Please note that some email servers (such as hotmail) can be unreliable in both sending and receiving messages. Students must make sure that their messages do not include language or logos or

reply email addresses that may be offensive. Each email message must include in the “subject” the course number (ECO358H1F) and a concise and clear statement of purpose — otherwise it will be deleted, along with spam messages, financial scam letters and messages potentially containing viruses. In the first few weeks of class, please include your full name and your student number in your message.

Where a question cannot easily or briefly be answered with a reply email, I will simply indicate to the student that s/he should see me during the announced office hours. I will not explain concepts or the like via email under any circumstance.

Tentative Course Structure

Week 1: (September 14) Basics of financial markets. (BKMPR Ch. 1-3 & lecture notes)

Week 2: (September 21) The time value of money. (RWJR Ch. 4, 5, CW Ch. 1, 2 & lecture notes)

Week 3: (September 28) Bond pricing; the term structure of interest rates. (BKMPR Ch. 2 and 13-14 & Lecture notes)

Week 4: (October 5) Choice under uncertainty, portfolio theory I. (BKMPR Ch. 6, & lecture notes)

Week 5: (October 12) Portfolio theory II (BKMPR Ch. 7 & lecture notes)

Week 6: (October 19) Midterm 1

Week 7: (October 26) CAPM (BKMPR Ch. 8).

Week 8: (November 2) Basics of general equilibrium theory, no-arbitrage, the law of one price (lecture notes).

Week 9: (November 9) Single and multi-factor models. Arbitrage pricing theory (BKMPR Ch. 9 & lecture notes)

Week 10: (November 16) Midterm 2

Week 11: (November 23) Empirical evidence of market returns. BKMPR Ch. 10. Market efficiency.

Week 12: (November 30) Option pricing BKMPR Ch. 18 & 19.