

ECO 2503H1 L0101  
Financial Economics I (MA)  
Fall Term 2013  
R 4-6 in ES B142

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Office hours: R 12-1 and by appointment

## Course Description

The aim of this course is to survey the major theories, tools, and results in asset pricing and portfolio choice. Although modern finance is a highly mathematical field, we will use mathematics only to enhance our understanding – “the major hurdles in Finance are conceptual rather than mathematical” (John Cochrane).

Most of the course will focus on “classic” asset pricing, which is the foundation for any finance course that you might take here at UofT or anywhere else. As this class is intended to be a survey course, I would like students to get “the big picture”, both conceptually and with respect to applicable tools. I also want you to be able to understand the gist of academic research papers, and learn some key empirical facts about financial markets.

## Evaluation

There are three evaluation components:

1. A midterm (30%)
  - Week 6 (October 14-18)
  - Time and venue will be announced on Blackboard
2. An assignment (30%)
  - First part (3%) due by 4PM on Thursday, October 3
  - Final write-up (27%) due by 4PM on Thursday, November 14
3. A final exam (40%)
  - The exam is cumulative
  - Time and venue will be announced on Blackboard

The overall grade for the course will be calculated as the weighted average of the three evaluation components with the weights given above. There is one exception to this rule.

Students who

- a) have taken the midterm **and**
- b) achieved a passing grade on the midterm **and**
- c) did better on the final exam than on the midterm

will have their midterm grade dropped and the 30% weight of the midterm shifted to the final. That is, their overall grade for the course will be calculated from their assignment grade (with a weight of 30%) and their final exam grade (with a weight of 70%).

*Permitted examination aids:*

1. A simple pocket calculator (no graphic or financial calculators are allowed)
2. A formula sheet. The formula sheet must be hand-written i.e. not type-set, and not photocopied. It may contain only formulae or simple expressions, but not full paragraphs of text, lists, bullet points, derivations of formulae, or solutions to past questions. The size specifications of the formula sheet are as follows:
  - a. for the midterm, you may use one side of an A4/letter (210mm × 297mm or 216mm × 279mm) page with formulae.
  - b. For the final exam, you may use two sides of an A4/letter page.

**General Policies***Appeals*

If you appeal to re-grade one of the midterm or exam questions, I will re-grade the entire midterm/exam. Note that this may (and in the past usually has) lead to a lower overall grade. Your complaint has to be in writing and you must give a detailed outline as to why and where you think that the assessment is inaccurate.

*Not handing in an assignment*

If you miss the deadline for an assignment part, you should contact me immediately. Late assignments carry a penalty of 10% per hour.

*Practice Problems*

In most sets of lecture slides I will include some practice problems. I will also post past exams on Blackboard. Neither of these will have accompanying solutions. Please contact me during office hours if you have questions about how to solve practice problems or questions from past exams. No further practice problems will be provided.

*Plagiarism*

Plagiarism is a severe academic offense.

By submitting your assignment you certify that you have read and understood the university's policies on plagiarism. Please also consult the university's website on academic writing: <http://www.writing.utoronto.ca/advice/using-sources/how-not-to-plagiarize>.

If I detect plagiarism, I will go through the standard process for academic misconduct.

*Contact*

For questions about the class material, please come to my office hours.

E-mails and the discussion board on the portal should be used only for questions regarding logistics and organization of the course. If your question is of general interest, please post it on the discussion board. I will try to answer e-mails and posts on the discussion board by the end of the next business day. E-mail queries about class material that require lengthy answers will receive the following answer: "Please see me during my office hours." When sending an e-mail please use your University of Toronto e-mail address. Also, please mention the course code, "ECO2503" in the subject line of your message.

*Acceptable Medical Notes*

- The only accepted note is a fully completed University of Toronto Medical Certificate. You can find a copy of the form here: <http://www.illnessverification.utoronto.ca/>
- It must be **original** and completed by a qualified medical doctor (e.g., not an acupuncturist, chiropractor, or other health care professional).
- The doctor's OHIP registration number must be provided on the note.
- If you miss an exam or midterm, the note must clearly state that on the date of exam or midterm, the student was too sick to write the test. Illness before the test is not sufficient grounds for missing the test. Nor will I accept notes that indicate that the student would have performed "sub-optimally".

**Course Outline and Readings**

The complete outline and list of readings will be posted on Blackboard during the first week of the course.

*Planned coverage*

1. An introduction to asset pricing, net present value, internal rate of return
2. Investor preferences and risk
3. Bond pricing
4. Mean-variance analysis and portfolio choice
5. The Capital Asset Pricing Model and various extensions: asset pricing with exogenous risks
6. Arbitrage Pricing Theory, factor asset pricing models
7. The law of one price, arbitrage, state prices, stochastic discount factor
8. Consumption-based asset pricing, the equity premium puzzle, ICAPM, Hansen-Jagannathan bounds
9. Empirical evidence on security returns, efficient financial markets