

ECO 2503H1 L0201
Financial Economics I (MFE)
Fall Term 2019

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Office hours: T 11-12, T 3-4

Course Description

This course is a primer in asset pricing emphasizing the underlying economic theory and placing some recent empirical results in the context of the theory. We survey the major theories, tools, and results in asset pricing and portfolio choice. The course presents a general framework for pricing (financial) assets, and the economic foundations for how individual preferences impact these prices. The course also covers the role of financial markets in sharing risk in the economy, and presents recent empirical evidence on the determinants of asset returns.

The expectation is that students who successfully complete the course should be able to:

- 1) Apply standard theories that explain asset prices as an equilibrium outcome in financial markets, critically assess the assumptions the theories make, and point out their limitations.
- 2) Explain the most important empirical facts about asset returns and the extent to which the models introduced in the course can successfully account for variation in asset returns.
- 3) Construct portfolios of financial assets and assess their performance.

Meetings

Lectures are Mondays 1:10 to 4:00, in GE 100. We will not always make use of the 3.00-4.00 time slot. Throughout the term, I will announce ahead of time whether we are using the 3.00-4.00 slot in a particular week.

Make-up Monday

There is no class on Monday October 14 (Thanksgiving Day). In line with university policy, “make-up Monday” is scheduled for Thursday December 5. I have put in a room booking request to ensure that we have classroom space for the make-up class. Whether this make-up class is taught or not depends on the progress we make with the material during the term – and the use of the additional hour on Mondays.

Evaluation

There are three evaluation components:

1. A midterm (30%)
 - Monday October 28, 1-4
 - Exam room will be announced on Quercus
2. An assignment (30%)
 - First part due by 13.10 on Monday, September 23
 - Final write-up due by 13.10 on Monday, November 18
 - Please see the separate document titled “Assignment for ECO2503 MFE, Fall 2019” on Quercus for further details on content and group allocation
3. A final exam (40%)
 - The exam is cumulative
 - Exam time and room will be announced on Quercus

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) 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)

Teaching Assistant

The teaching assistant (TA) for the course is [Louis-Etienne Salmon-Belisle](#). He is responsible for grading midterms and assignments. He will hold office hours after the midterm to address any questions regarding the grading of the midterm. An announcement will be made on Quercus to inform you of the time and venue of such office hours.

General Policies

Appeals

If you appeal to re-grade one of the midterm, assignment, or exam questions, I will re-grade the entire midterm/assignment/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. An exception to this rule is if you claim that a mistake was made when adding up your grades.

Not handing in an assignment

If you anticipate that you may miss the deadline for an assignment deliverable, 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 solutions (or solution outlines) to selected problems. Further, I will post a sample exam and a sample midterm test on Quercus, along with solutions (or solution outlines). Please contact me during office hours if you have any 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](#). If I detect plagiarism, I will go through the standard process for academic misconduct.

Contact

- a) I hold office hours each week during the term (i.e. while classes are taught). There are no office hours on November 5 (reading week). To ensure that you get the most out of these, please come prepared with specific questions. Please be mindful of other students who may also wish to talk to me during this time. Finally, I kindly ask you to respect the schedule of my office hours.
- b) For questions about the class material, please come to my office hours.
- c) For organizational matters, please refer to this syllabus and the course outline first
- d) E-mails should be used only for questions regarding logistics and organization of the course. I will try to answer e-mails by the end of the next business day. 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.
- e) **If you do not receive a response from me by the end of the next business day, the most likely reason is that one of (b)-(d) above are not satisfied.**
- f) Please check the course website on Quercus regularly, especially course announcements.

Missing a test

Missing a term test due to illness:

- The only accepted note is a fully completed [University of Toronto Medical Certificate](#).
- It must be **original** and completed by a qualified medical doctor (e.g., not an acupuncturist, chiropractor, or other health care professional).
- The physician's OHIP registration number must be provided on the note.
- I will not, under any circumstances, accept post-dated medical notes. The physician's report must establish that the patient was examined and diagnosed at the time of illness, not after the fact.
- 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".

- Only original notes will be accepted. I will not accept photocopies or emailed certificates.
- To comply with these requirements, it is expected that the student will have met with the doctor on the date of the test.
- **The student must email me the day of the test to indicate that they will not be able to write the test.**
- I will review each sick note to determine whether there are sufficient grounds for a student to be excused from a test. Part of this review process may include meeting with the student, and/or following up with a physician.
- It is an academic offense to feign illness to avoid a test.

Missing a term test due to another excused absence (e.g., funeral, car accident):

- The note must be accompanied by a note from a responsible third party that I can verify in order for excusal to be **considered**. The validity of the excuse will also be evaluated by academic staff in the Department of Economics.

If a student has been excused from the midterm test, he or she will be permitted to write a make-up test. The make-up test will be held during the term, after the midterm. Consistent with university policy, there is no “make-up test” for the make-up test. No medical excuses or scheduling conflicts will be accepted, and a grade of zero will be applied if a student fails to write the make-up test.

Feedback

Student feedback is the most important resource to continuously improve the course, and I take it seriously. I collect feedback in two formats.

- 1) Weekly (short) feedback: each week, you are welcome to submit your opinion about the week’s class, indicating what went well and what needs improvement. Please see the link “Weekly short feedback form” under course materials on Quercus.
- 2) “Halftime” evaluation: halfway through the course, after the midterm, you will be invited to answer a set of more detailed questions about your opinion on the course. A link to the online web form will be made available on Quercus.

Providing feedback is voluntary, strictly anonymous, and much appreciated.

Course Outline and Readings

Please see the document titled “Outline and Readings” on Quercus for the complete outline and list of readings. This document will be posted during the first week of the course. The outline is subject to change.

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

Additional Readings

I compiled a (very short) list of additional studies that you can read – in addition to the ones I mention/link in the lecture slides – if you are interested in asset pricing in general and/or as preparation for any upcoming interviews or informal conversations. This list will be posted on Quercus during the term.