

Financial Markets and the Macroeconomy
ECON435, Section 0101

Spring 2011

Instructor:

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Lecture: Tuesday and Thursday 2:00pm- 3:15pm in TYD 1132

Office Hours: TA: Monday 2:30 – 4:00pm and Friday 1:30 – 3:00pm
Professor: Thursday 3:30 – 4:30pm and by appointment

Course Description:

The goal of this course is twofold: (1) to provide an introduction into the workings of financial markets and (2) to analyze the role of financial markets for the broader macroeconomy.

The course will discuss the basic role of financial markets, the types of financial assets and how they are traded. We will introduce a number of technical tools for valuing risk, pricing financial assets and creating portfolios. Finally, we will employ these insights to discuss issues of broader relevance for the macro economy, with special emphasis on the current financial crisis.

Prerequisites:

The formal requirement for the course is having successfully taken ECON326, and the calculus methods you applied in that course will be frequently utilized. ECON435 also uses a number of statistical tools, so ECON321 is highly recommended as another prerequisite.

I will distribute a math handout and a problem set in our first two classes to help you review some of the mathematical concepts and tools that will be used in class. I strongly recommend that you work through these on your own to refresh your math skills, and that you come to office hours if you have any questions.

Textbook and Readings:

The main textbook for the course is “Investments” by Zvi Bodie, Alex Kane and Alan J. Marcus, McGraw-Hill/Irwin, 9th edition (2010), ISBN 978-0073530703. This book is an excellent source of how modern financial markets work and explains the basic tools that financial economists use to analyze them. The 6th, 7th or 8th edition of the book is also acceptable.

A second reading is the “Financial Times” (FT), a leading daily business newspaper, to which I strongly recommend that you subscribe. FT offers 15-week student online or print subscriptions, and Kindle subscriptions are available as well. You could also read the print version in the library. The FT will be an invaluable tool in preparing your in-class financial news analysis presentation and blog posting.

Composition of Grade:

- 10 % Class participation and investment game
- 16 % Financial news analysis presentation & blog posting
- 24 % Problem sets
- 30 % Quizzes (10 % each)
- 20 % Final exam

There will be no opportunities for extra credit. If at any point during the semester you face circumstances which prevent you from attending lecture, handing in problem sets on time, making a presentation and/or participating in quizzes or exams, please contact me as soon as possible to discuss ways to manage the situation. There is little that can be done after an unsatisfactory grade has been assigned.

Class Preparation and Participation:

Students are expected to be prepared for each lecture by studying the textbook chapters as indicated below. Furthermore, you are expected to follow our regular financial news discussion and analysis in class and online to connect the theoretical concepts that we are studying to what is going on in financial markets day-to-day. Preparing all of these materials will help you to actively and effectively participate in classroom discussions. This means regular class attendance is an expectation. You will be responsible for all the preparatory materials in your problem sets, quizzes and exams.

Financial News Analysis Presentation and Blog:

One of the main goals of our class is to actively follow actual events in financial markets. At the beginning of each class, we will review and discuss the financial news and developments since the previous class. To this goal, I will sign up a team of two students for each class to prepare a short presentation (approx. 10 – 12 min). During the week before your presentation, make sure to buy and read a financial newspaper every day and keep track of all important financial developments.

In your financial news presentation, (i) spend some time to discuss and analyze how markets performed since our last class and (ii) pick two to three specific news items that are closely related to topics we have covered in a recent lecture and present some in-depth research on these items. For this, read all related news articles from several different financial news sources (such Financial Times, Wall Street Journal, Bloomberg.com, MarketWatch.com, Yahoo! Finance, Google finance etc.) and compile a brief summary, analysis and comment. You should present this to class and post an online summary with links (around 300 – 400 words) to our financial news analysis blog at <http://econ435.tumblr.com/>. I urge all class participants to sign up to this blog and read it regularly to be well prepared for problem sets, quizzes and the final exam.

Virtual Investment Game:

In order to gain some practical experience with financial markets, I require that every student participates in a simulated stock market game – the University of Maryland Stock Market Challenge. Our class will have a separate group to which you have to subscribe, but you will also automatically participate in the university-wide challenge. Detailed instructions on how to sign up will be given within the first few weeks of the semester.

After the start of the game on Feb. 28th, you will be given a \$100,000 virtual margin account and be permitted to trade stocks and ETF's until May 1st. You are expected to buy at least one security by March 7th and to follow your virtual portfolio closely so that you can provide a brief update on how your investments have performed every class, if called upon. The goal of the investment game is to gain more practical insights into financial markets, but the performance of your investment portfolio will not impact your grade. (Exception: the mid-term winner and the final runner-up will obtain 3 bonus points; the final winner will obtain 5 bonus points).

We will determine who earned the highest returns mid-term, on Thursday after spring break, and by the end of the semester, April 29th. On March 31st and May 5th you are expected to hand in a short report (no more than 1 page) on your investment strategy and on how your investments have performed. (Please include your username on the report.) The winners will present their investment strategies to class.

At the university level, there will be a mid-contest meeting and a final awards meeting at which educational materials will be presented and the leaders will present their trading strategies. A cash award (\$400, \$250, \$100, \$50, \$50) and a certificate will be presented to the five participants whose portfolio has increased the most during the competition.

Problem Sets:

There will be six mandatory problem sets throughout the semester, each of which will be given equal weight. (In addition, I will distribute a math problem set to refresh your math skills that you acquired in ECON326.) The problem sets will help you to work through the materials covered in class and will be useful in your preparation for the mid-term and final exam. Therefore I assign an important weight of the final grade to your performance on problem sets.

Medical Excuses:

Students or a guardian must email me *prior* to class to inform me if they will not be in attendance due to illness or injury and thus will miss a class assignment/exam/deadline. In the very next class session that you are in attendance, you must present me with written documentation of your illness/injury (a copy of your medical notes is acceptable). If you do not inform me or if you do not present me with timely documentation, 0 points will be given to you for the missed assignment/exam.

For problem sets, the following rules apply: if you will have to miss a class, turn in your problem set by leaving it in my mailbox in the main office of the economics department (Tydings 3110, open until 4:30pm) or by slipping it under my office door (Tydings

4118F) *before the beginning of class*. If you are late, I will drop 33% of the points if you hand it in after class the same day and 50% of the points if you hand it in the day after its due date. Later submissions will not receive any credit.

Quizzes and Final Exam:

There will be three quizzes throughout the semester and one final exam. The material covered by the quizzes will be cumulative, but with special focus on the most recent materials. If you fail to take a quiz or exam, you will receive a zero score, unless your absence is due to one of the legitimate causes listed in the Undergraduate Catalog *and* you provide documentation for this as soon as possible.

You are responsible for all material in the relevant chapters of the textbook (see below), for the topics we discussed in our financial news analysis and blog and for what was covered in my lectures. If you miss any lectures, please make sure that you copy the notes of one of your colleagues.

Course Evaluations:

At the end of the semester, please let me know what you liked and what you disliked about this class by taking advantage of the University's on-line course evaluation system. I really appreciate your feedback – incorporating your suggestions will help me in updating the course for future generations of students.

Students with Disabilities:

Students with disabilities are required to get in touch with me within the first three weeks of classes and furnish the required documentary evidence. I will be happy to accommodate your needs.

Academic Integrity:

The University of Maryland, College Park has a nationally recognized Code of Academic Integrity, administered by the Student Honor Council. This Code sets standards for academic integrity at Maryland for all undergraduate and graduate students. As a student you are responsible for upholding these standards for this course. It is very important for you to be aware of the consequences of cheating, fabrication, facilitation, and plagiarism. For more information on the Code of Academic Integrity or the Student Honor Council, please visit <http://www.shc.umd.edu>

Preliminary Course Outline (details will change over the course of the semester):

Date	Topics	Book	Materials Due
1/25	Introduction	Ch. 1	
1/27	Role of the Financial System	Ch. 1	
2/01	Money Markets	Ch. 2	Math practice problems
2/03	Bond Markets	Ch. 2	
2/08	Equity Markets	Ch. 2	
2/10	Security Trading	Ch. 3	
2/15	Security Trading	Ch. 3	Problem set 1
2/17	<i>Quiz 1</i>		
2/22	Mutual Funds	Ch. 4	
2/24	Risk in Financial Markets	Ch. 5	
3/01	Dealing with Risk	Ch. 6	Problem set 2
3/03	Diversification	Ch. 7	
3/08	CAPM	Ch. 9	
3/10	Efficient Market Hypothesis	Ch. 11	
3/15	<i>Quiz 2</i>		Problem set 3
3/17	Bond Prices and Yields	Ch. 14	
Spring Break			
3/29	Term Structure	Ch. 15	
3/31	Mortgage Markets	Slides	Mid-term report investment game
4/05	Mortgage Markets	Slides	Problem set 4
4/07	Options	Ch. 20	
4/12	Futures and Swaps	Ch. 22	
4/14	<i>Quiz 3</i>		
4/19	Risk Management	Ch. 23	Problem set 5
4/21	International Financial Markets	Ch. 25	
4/26	Origins of the Financial Crisis	Slides	
4/28	Crises and Systemic Risk	Slides	
5/03	Effects of the Crisis on Banks	Slides	Problem set 6
5/05	Effects on the Broader Economy	Slides	Final report investment game
5/10	Final Review		
5/16	<i>Final Exam: 10:30am – 12:30pm</i>		