

BUSINESS ADMINISTRATION 454

Global Capital Markets Fall Semester 2008

- INSTRUCTOR: Deborah N. Pittman
OFFICE: 329A Buckman Hall
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OFFICE HOURS: 1:00-2:00 and 5:00-6:00 Tuesday and Thursday
Other times by appointment
- REQUIRED TEXTS: *International Financial Management*, Madura, 9th Edition
All About Derivatives, Michael Durbin
- OTHER READINGS: On reserve in the library or placed in folder
- REQUIRED: Financial calculator
- REQUIRED: Daily reading of Wall Street Journal

When you invest, you transfer current cash flows to the future; when you borrow, you transfer future cash flows to the present. Cash transfers across time is a primary goal of all financial activity, called *intertemporal cash flow shifting*. The second major goal of financial activity is risk transfer. Risk is uncertainty about future outcomes. Although some of us have more tolerance for risk than others, no one likes it. Financial activity allows us to reduce the overall level of risk as well as to transfer some unavoidable risk to those who are most willing to bear it. Everything we will learn in this course bears directly upon these two primary goals of financial activity.

In the last few years, there has been much attention paid to the money and capital markets. They convert the public's savings into investments so the economy can grow, creating new jobs and a better quality of life. The financial system makes an essential contribution to today's economy and to society. When the financial system falters, as it has this past year, we need to understand why. We will follow the credit market crisis, the price of the dollar in foreign exchange markets, the price of oil, the trends in the U.S. economy, stock market prices, and bank failures during the semester in order to understand how the theory we've studied applies to the actual markets.

Course Objectives:

By the end of the course, my goal for this class is that you will:

- Understand the theoretical connections between interest rates, foreign exchange rates, and inflation
- Understand various theories on how exchange rates are determined in the marketplace
- Understand various theories of interest rate determination in the marketplace
- Understand nature, risk and pricing of option, futures, and forward contracts in general
- Understand asset liability management in commercial banking, including VAR analysis

- Be familiar with a variety of fixed income securities including: money market instruments, conventional and indexed bonds, securitized bonds such as CDO's, CLO's, CMO's.
- Be familiar with specific derivatives contracts that relate to fixed income securities including: credit swaps, interest rate swaps, credit default swaps.

Part One of the course is an overview of international finance and the key economic parity theories that relate the concepts of foreign exchange rates, inflation, and interest rates. This is background information necessary to understand how foreign exchange rates are determined in the global capital markets, and how they in turn impact inflation and interest rates.

Part Two of the course builds on this foundation and adds interest rate determination, yield curves, and duration, and various risks of the credit markets. Bond pricing should be better understood by the end of part two.

Part Three of the course extends what we've learned to derivatives markets

Part Four of the course will have some speakers talk about sectors within the credit markets.

Grading:

The grading scale is as follows:

97-100	A+
93-96	A
90-92	A-
87-89	B+
83-86	B
80-82	B-
77-79	C+
73-76	C
70-72	C-
67-69	D+
63-66	D
60-62	D-
< 60	F

Grades will be based on the following:

Section Test 1	30%
Section Test 2	30%
Comprehensive Final	<u>40%</u>
	100%

Course Structure:

I have designed this course to provide a financial background in the fixed income area of the discipline. In order to understand the fixed income market, there is a great deal of background that is essential. Fixed income securities are far more than money market instruments and bonds. Trillions of dollars are being invested in newer, and more complex underlying securities, but also in derivatives contracts that cover both the more conventional as well as more complex securities.

Thus, I have structured the course to give you an understanding first of the relationships between foreign exchange rates, interest rates, and inflation. Some of these relationships are not just theoretical relationships, since some are kept stable by riskless arbitrage in the marketplace. Then we add an understanding of what causes interest rates to change, i.e. what are the various determinants of interest rates? Finally, we will focus on the derivatives market and the various types of instruments.

You will have much outside reading. I will add other readings as needed. You are responsible for this reading on tests. I will use class time to discuss topics related to the readings, and will highlight for you the important information in the readings and go over the more difficult aspects of that important information. Your class notes will be important as you prepare for tests. You will have guest speakers, and you are responsible for their lectures on the tests as well.

day	Date	comment
Thursday	August 28	In class: Introduction to Study of International Financial Markets (ppt. Levich)
Tuesday	September 2	Read handout : Why Do Financial Intermediaries Exist? (Arshadi and Karels)
Thursday	4	Read handout : Credit Crunch Q&A (Greycourt Investment Advisors)
Tuesday	9	Watch Trillion Dollar Bet in class: answer questions in class Read Chap 2, Madura
Thursday	11	Read Chap 3, Madura; discuss in class Chap 2 and 3
Tuesday	16	Read Chap 4, Madura; Exchange Rate Determination; discuss chapter in class
Thursday	18	Read Chap 5, Madura, pp 103-114 only; discuss chapter in class
Tuesday	23	Read Chap 7, Madura; discuss chapter in class
Thursday	25	Read Chap 8, Madura; discuss chapter in class
Tuesday	30	Chapter 8 continued; review and pass out Take Home Test #1
Thursday	October 2	Take Home Test Due ; Review RWJ Chapter 7; lecture on bond pricing in class Read handout Structure of Interest Rates (Melicher, Welshans, and Norton)
Tuesday	7	Read duration handout : Discuss structure of interest rates
Thursday	9	Discussion of Duration
Tuesday	14	Read Credit Risk handout (Duffie and Singleton),pp. 26-42
Thursday	16	Continued
Tuesday	21	Fall break
Thursday	23	Read Derivatives in a Nutshell Chapter 1; discussion in class
Tuesday	28	Read Derivatives in a Nutshell Chapter 2; discussion in class
Thursday	30	Read Derivatives in a Nutshell Chapter 3: discussion in class
Tuesday	November 4	Read Derivatives in a Nutshell Chapter 4: discussion in class
Thursday	6	Read Derivatives in a Nutshell Chapter 5: discussion in class
Tuesday	11	Read Derivatives in a Nutshell Chapter 6; discussion in class
Thursday	13	Read Derivatives in a Nutshell Chapter 7: discussion in class
Tuesday	18	Read Derivatives in a Nutshell Chapter 8: discussion in class
Thursday	20	Take Home Test #2 Due
Tuesday	25	Outside speaker
Thursday	27	Thanksgiving Break
Tuesday	December 2	Outside speaker
Thursday	4	Outside speaker
Tuesday	9	Outside speaker

Fri-Wed	12-17	Final Exams
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Important Dates

day	date	event
Tuesday	August 26	Enrollment Clearance/Registration
Wednesday	27	Classes begin Opening Convocation
Monday	September 1	Labor Day Recess
Wednesday	3	Drop/add period ends
Thursday	4	Extended drop period begins
Wednesday	17	Extended Drop Period Ends Pass/Fail Option Ends
Thursday	18	Withdraw Period begins
Wednesday	24	Last day to remove conditional grades
Friday	October 17	Fall recess begins at 5:00 p.m.
Monday	20	Mid-term grades due to Registrar, 9:00 a.m.
Wednesday	22	Classes resume at 8:00 a.m.
Friday	31	Withdraw Period Ends
Tuesday	November 25	Thanksgiving Recess begins at 10:00 p.m.
Monday	December 1	Classes resume 8:00 a.m.
Wednesday	10	Last day of classes
Thursday	11	Reading day
Fri-Wed	12-17	Examinations
Friday	19	Final grades due to registrar's office 5:00 p.m.