

FIN 371M - Spring 2011

Money and Capital Markets

Instructor: Richard Lowery
Office: CBA 6.324
E-mail: richard.lowery@mcombs.utexas.edu
Office Phone: (512)232-6823

Class: MW 9:30-10:45, 11:00-12:30, 12:30-2:00 in UTC 1.132
Office Hours: 2:00-3:30 pm, MW
and by appointment

Textbook

Foundations of Financial Markets and Institutions by Frederic S. Mishkin and Stanley G. Eakins, Prentice Hall (ISBN 978-0-321-37421-9). I recommend obtaining electronic access to the textbook, which is appreciably cheaper.

Additional Readings

Readings will also be drawn from: Investment Banking: Institutions, Politics, and Law by Alan D. Morrison and William J. Wilhelm, Jr., Oxford UP (978-0-19-954418-9), which is available as an electronic resource via the UT library. I will also probably place the hard copy on reserve.

Other readings will be made available throughout the semester. Students are encouraged but not required to subscribe to and read *The Wall Street Journal*.

The syllabus also lists a number of “readings” from economics and finance journals. Some of these will be assigned readings, while others are references for material covered in lectures. Articles marked with an asterisk are likely to contain more advanced material. Students may find the introductions to these articles to be useful supplements to notes taken during lectures.

The readings listed on the syllabus are NOT final reading assignments, but are just a general guide. Final reading assignments will be mentioned in class and/or posted on blackboard. Assignments will be posted no later than 6:30 pm on the class day preceding the class when the reading should be completed.

I plan to regularly email links to *Wall Street Journal* articles for the purpose of class discussion. This discussion will make up a significant portion of your class participation grade.

Purpose of the Class

This class is designed to provide institutional and theoretical foundations for the wide variety of financial assets in a modern capital market. We will focus on how the needs of investors and the needs of firms interact to produce the often bewildering array of financial instruments available. A major topic in the class will be how government intervention influences the the development of such markets. We will also address why markets for money and capital seem predisposed to periods of crisis and we will address the concept of “systemic risk” within a financial system.

Format of the Class

Classes will take the form primarily of lectures, but most classes will begin with a discussion of some recent event in the financial markets. You are expected to actively participate in a least some of these discussions. I also anticipate assigning at least two cases, and in the case presentations students are

expected to prepare reports in teams and be prepared to discuss or present their results when called upon to do so. Part of some class periods will be devoted to games, which are explained further below. My intention in lectures is to focus on presenting the economic theory that informs our understanding of the various markets and instruments that we study in addition to institutional details of the various markets. Lectures will also present current empirical work in financial economics relevant for the current topics.

Notes on the Calendar

Spring Break is from March 14 to March 19.

Course Policies

- Students are responsible for all material in the reading and in the lectures. These will not always overlap.
- Students are responsible for finding out about any administrative announcements made during lectures that they miss.
- Use of electronic equipment (laptops, cell phones, etc.) is prohibited without special approval. Calculators may be used in class, though I doubt they will be needed.
- **No student may leave any exam early, except as a result of illness. You will be permitted to (quietly) do something else after turning in the exam, but no electronic devices may be used at any time during the exam.**

Makeups

Students missing an exam for good reason, including and more or less limited to (documented) illness or death (or extremely serious illness) in the immediate family, may be given the opportunity to make up the exam or may instead have the remaining exams count for a higher percentage of the grade, at my discretion. Students missing an exam for a reason that I do not consider “good” (e.g. oversleeping, travel for weddings) will, at my discretion, either (1) receive a zero on the exam or (2) take the makeup exam and receive the lower of the two class grades, calculated with and without the makeup exam. ANY ATTEMPT TO ABUSE THIS POLICY OR TO EXPLOIT MAKEUPS TO PASS INFORMATION ABOUT THE EXAM WILL BE CONSIDERED THE MOST AGGRAVATED FORM OF CHEATING.

Students with Disabilities

The University of Texas at Austin provides upon request appropriate academic accommodations for qualified students with disabilities. For more information, contact the Office of the Dean of Students at 471-6259, 471-4641 TTY.

Academic Integrity

I will pursue the most severe available consequences for any act of cheating. To be more specific, I am unlikely to respond to any act of scholastic dishonesty by assigning a grade of F on the *assignment* in question. The final decision on these matters rests with the University administration.

Official University Statement: *The McCombs School of Business has no tolerance for acts of scholastic dishonesty. The responsibilities of both students and faculty with regard to scholastic dishonesty are described in detail in the Policy Statement on Scholastic Dishonesty for the McCombs School of Business: By teaching this course, I have agreed to observe all of the faculty responsibilities described in that document. By enrolling in this class, you have agreed to observe all of the student responsibilities described in that document. If the application of that Policy Statement to this class and its assignments is unclear in any way, it is your responsibility to ask me for clarification. Policy on Scholastic Dishonesty: Students who violate University rules on scholastic dishonesty are subject to disciplinary penalties, including the possibility of failure in the course and/or dismissal from the University. Since dishonesty harms the individual, all students, and the integrity of the University, policies on scholastic dishonesty will be strictly enforced. You should refer to the Student Judicial Services website at <http://deanofstudents.utexas.edu/sjs/> or the General Information Catalog to access the official University policies and procedures on scholastic dishonesty as well as further elaboration on what constitutes scholastic dishonesty.*

Games

Portions of several class periods will be dedicated to games, most of which are based on papers in the experimental economics literature. Games will be played with experimental currency, and I will keep track of each player's earnings. Final earnings in each class period are completely separate, and negative balances will be ignored. That is, if you perform very badly in one game, it will not ruin your chances of coming out ahead in another game and will certainly not hurt your score on an exam or anything. At the end of the class, I will convert experimental currency balances into class participation points at an exchange rate that I will determine. It is highly unlikely that anyone's grade will change as a result of performance in the games, but you will learn more and possibly have more fun if you pretend like it matters. I will NOT use any data collected for any purpose other than teaching this class, improving the experiments for future years, or, possibly, presenting the data in future classes. The data will *not* be used as part of any research project.

Class Participation and Attendance

Class participation is a significant portion of your grade. The primary way to earn a good score on class participation is to actively participate in the discussions of current events that will generally take place at the beginning of class. This will require being prepared by reading the suggested articles that I will send. You have the option of turning in a bi-weekly report of your own class participation if you are concerned that I will not remember your active participation. Also, if you no longer resemble the picture that the university has for you on file, please introduce yourself to me at some point.

Attendance is not mandatory, but you are unlikely to perform well on the class participation dimension if you do not attend class regularly.

Any student scoring in the top 95% on one exam and the top 90% on the other two will automatically receive full credit for class participation.

Final Presentation

The last three class meetings will be dedicated to student presentations. Depending on final enrollment, this project will be completed either individually or in teams of two. You will be expected to select some topic related to the class but not covered directly. The assignment will have two parts; a written report and a 10 minute presentation. You are more than welcome to select a topic related to something covered early in the class and complete the project well before the end of the semester to avoid conflicts with exams and other assignments. If you choose to do this and would prefer to present earlier in the semester, please let me know.

Cases

I anticipate assigning two cases, which will be completed in teams. You will be required to turn in a brief case report and be prepared to discuss the case in class. Active, prepared discussion of these cases will be an important part of your class participation grade.

Problem Sets

There will be occasional problem sets which will **not** be collected. Many of these problems, however, will appear in some form on the exams. Class time will be allocated to answer questions about the problems, and students are welcome to attend office hours to ask questions about these problems *around the time they are assigned*. If you wait until immediately before the exam to ask questions about these problems, you can expect cursory answers at best. At my discretion, I may post solutions to some of the problems, but it is your responsibility to work out the problems and ask questions in class. **Do not count on using the solutions to study for the exams in lieu of actually working out the problems yourself.**

Grading

Exam I:	20%
Exam II:	20%
Exam III:	20%
Case reports/presentation:	25%
Class participation:	15%

The class will be “curved” in the sense that there is no established mapping between numerical grades on exams and final grades. I will provide sufficient statistical information about the distribution of grades on exams and other assignments that you will be able to tell where you stand. As a general rule, the percentage grades on my exams runs much lower than in other classes, but this is **COMPLETELY IRRELEVANT** for the distribution of final grades. Final grades will be determined by performance relative to the mean on each assignment, as measured by the standard deviation.

In the final assignment of grades I will endeavor to approximately match the distribution of grades standard for elective courses in finance, although I reserve the right to shift the distribution based on aggregate performance. I plan to make full use of the new +, – grading system. In determining final grades, I will balance a target for the final distribution with a criteria for minimizing the number of students who are very close to cutoffs. Details of the algorithm will be available upon request.

Students turning in assignments late without good reason will generally receive a zero on the assignment. Students failing to turn in an assignment at all will fail the class except in extraordinary circumstances.

Grading Disputes

You will have an opportunity to look over your exams during class and to look at them further in the Finance office. I may field questions about grading during the class in which we go over the exam, but all further grading complaints must be submitted *in writing*.

Class website

Password-protected class sites will be available for all accredited courses taught at The University. Syllabi, handouts, assignments and other resources are types of information that may be available within these sites. Site activities could include exchanging e-mail, engaging in class discussions and chats, and exchanging files. In addition, class e-mail rosters will be a component of the sites. Students who do not want their names included in these electronic class rosters must restrict their directory information in the Office of the Registrar, Main Building, Room 1. For information on restricting directory information see: <http://www.utexas.edu/student/registrar/catalogs/gi02-03/app/appc09.html>.

Course Outline

Below is the **preliminary** outline of the course.

Unit 1 : Overview and review of interest rates

Week 1, class 1 Overview of financial assets and financial institutions. Chapters 1, 2

Week 2, class 1 Why Financial Institutions exist: Adverse selection, moral hazard, and transaction costs. Chapter 15

Week 2, class 2 Conflicts of interest and reputation in financial intermediation. Begin interest rates. Chapter 16, 3, and 4

Week 3, class 1 Finish interest rates. Market efficiency. Chapter 6.

- Asset Fire Sales (and Purchases) in Equity Markets. Joshua Coval and Erik Stafford. *Journal of Financial Economics*. November, 2007.

Week 3, class 2 Bubbles.

- Famous First Bubbles. Peter M. Garber. *The Journal of Economic Perspectives*. Vol. 4, No. 2, Spring 1990.

Unit 2 : Depository institutions and central banking.

Week 4, class 1 Depository institutions. Chapters 17, 18, and 19

Week 4, class 2 Banking regulation. Chapter 20.

Week 5, class 1 **EXAM I**

Week 5, class 2 Banking panics.

- Bank runs, Deposit Insurance, and Liquidity. Douglas W. Diamond and Philip H. Dybvig. *The Journal of Political Economy*, 1983.*
- The Role of Demandable Debt in Structuring Optimal Banking Arrangements. Charles Calomiris and Charles Kahn. *The American Economic Review*, 1991.*
- Excerpt from Sherman's memoirs
- The Free Banking Era: A Reexamination. Hugh Rockoff. *Journal of Money, Credit, and Banking*, 1974.

Week 6, class 1 Central banking. Chapters 7, 8.

Week 6, class 2 Central banking.

- Introduction to *A History of the Federal Reserve, volume 1*. Allan H. Meltzer.
- Afterword to *A History of the Federal Reserve, volume 2*, reprinted in *The Road ahead for the Fed*.

Unit 3 : Debt markets

Week 7, class 1 Money markets, including commercial paper and auction rate securities. Chapter 9.

Week 7, class 2 Money markets continued, interventions in money markets.

- The Federal Reserve's Term Auction Facility. *Current Issues in Economics and Finance*. Vol. 14, Number 5, July 2008. <http://www.utexas.edu/student/registrar/catalogs/gi02-03/app/appc09.html>
- The Federal Reserve's Commercial Paper Funding Facility. Staff report no. 423. January, 2010.

Week 8, class 1 Municipal bonds and auction rate securities.

Week 8, class 2 Auction rate security case.

Week 9 SPRING BREAK

Week 10, class 1 Corporate Bond markets/review. Chapter 10.

Week 10, class 2 EXAM II

Unit 4 : Equity markets and investment banking

Week 11, class 1 Equity markets. Chapter 11

Week 11, class 2 Investment banking. Chapter 23

Week 12, class 1 Mortgage markets. Chapter 12

Week 12, class 2 Asset backed securities.

- The Panic of 2007. Gary Gorton. NBER Working paper.

Week 13, class 1 Rosetree case. Foreign exchange. Chapter 13

Week 14, class 2 International financial crises. Chapter 14

Week 15, class 1 Derivatives. Chapter 25

Week 15, class 2 Derivatives continued, and responses to the financial crisis.

Week 16, class 1 EXAM III

Week 16, class 2 PRESENTATIONS

Week 17, class 1 PRESENTATIONS

Week 17, class 2 PRESENTATIONS