

EC4024 FINANCIAL ECONOMICS

LECTURER: DR. STEPHEN KINSELLA
OFFICE: KB3-42
EMAIL: stephen.kinsella@ul.ie
WEB: WWW.STEPHENKINSELLA.NET
OFFICE HOURS: BY APPOINTMENT

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TUTOR: MS. DONNA LYONS
OFFICE: KB2-37
EMAIL: donna.lyons@ul.ie
OFFICE HOURS: TUES 1000-1200

MODULE OUTLINE: Finance is the applied wing of economics. This course is about introducing students to the economics of finance via the study of several canonical models, building on the economics you will have learned in *Economics for Business* last semester.

We will begin with data. First, we'll describe the categories within which financially important variables exist, and develop ways to encapsulate them using simple statistics drawn from the study of simple probability distributions. We will develop graphical tools to analyse market movements in the lectures. Then we will move on to the study of financial history, to show the influence of uncertainty and 'Black Swans' on the markets, and to help you understand just how little we as economists really know about the markets and how they move. We will develop three simple but flawed models used to benchmark markets to round out the course, which every person interested in finance must know, as these models begin many of the conversations one might have about a stock or a bond. Then we will pull these models apart, so you know more than most leaving a course like this at the undergraduate level.

LEARNING OUTCOMES: If you work hard and do well in this course, you'll have learned

1. How to read the financial pages
2. What a stock, bond, or any risky asset is, and how to value it
3. The economists' approach to decision making under uncertainty
4. The canonical models of finance: CAPM, APT, and Black-Scholes
5. Elementary probability theory and data analysis
6. Episodes in financial history.
7. The structure of the international financial system.

THEMES: This course is roughly designed around the following statements inspired by Mandelbrot and Hudson, (2004). The course will expand upon each of them as we go through the lectures.

1. Markets are Turbulent;
2. Markets are very, very risky---more risky than most theories imagine;
3. Timing in Markets Matters greatly. Big gains and losses, as we shall see, are concentrated in short spaces of time;
4. Prices often leap, they do not glide. There are thresholds to risky portfolios held;
5. In markets, time is flexible;
6. Markets in all places, and at all times, are alike;
7. Markets are inherently uncertain, and bubbles are inevitable;
8. Markets are deceptive;

9. Forecasting prices is perilous, but you can forecast the odds of future volatility;
10. In financial markets, the idea of 'value' has limited value.

LECTURE MATERIAL: All the lecture notes, programs, data, handouts and podcasts of the lectures will be available *after* the lecture from www.stephenkinsella.net. Just click on the course page (EC4024) to access these materials.

There is a course pack of readings available for download from the site. These are required readings I've put together for you to make things a little easier on you.

The textbook for the course is Pilbeam, 2005, *Finance and Financial Markets*. There are copies on order in the bookshop, and two copies are on 3 hours loan in the library.

There will also be lecture notes, handouts, and exercises distributed throughout the module.

GRADING POLICY: To get a grade for this course, you will need to complete three problem sets, due in at the end of weeks 4, 8, and 11, respectively, worth 10% each. You'll do a final exam worth 70%. The Summer repeat will be worth 100%, should you fail.

MINI PRESENTATIONS: Throughout the class, we'll be doing 'mini presentations' on concepts and definitions. You'll be chosen at random to work in groups of 2 to come up with a definition of a concept, say, standard deviation, and a numerical example. You'll have 5 minutes to present this in class. Mini presentations will start in week 2. If you do *not* want to be called as a volunteer, send me an email saying so by the end of week 1.

LECTURES: There are two lectures a week, on Mondays at 10 in S205 and Fridays at 1300 in S205.

TUTORIALS: Each student has been allocated a tutorial hour and must attend that class. If, for legitimate reasons, the student needs to change to another hour they must agree this with the tutor beforehand. Tutorials commence in Week 3 of term.