

Financial Economics 709036

Fall Semester 2013/2014

Prof. Dr. Alex Stomper

Dr. Juliusz Radwanski

Contact Information

Office: Dorotheenstrasse 1/306

Telephone: +49 30 20935613

Web: Moodle

Office hours: Wednesdays, 8-10 a.m.

(or by appointment)

Course Structure

This seminar is designed to introduce you to the field of asset pricing and portfolio choice. It will consist of two parts. In the first, we will give a series of lectures on key topics in Financial Economics. The style of presentation will be informal, but constrained by the quantitative nature of the field. In other words, we will use math. We expect students to possess prior operational knowledge of calculus, probability, and basic time series analysis (AR processes). Following the textbook (see below), analysis will be performed in discrete time, which greatly reduces technicalities, while preserving all economic intuition. In the second part of the seminar, the students will be asked to present papers chosen from a list (TBA), which will expose them to the current research frontier in Asset Pricing.

Objectives and Philosophy

The course focuses on Financial Economics through the lens of standard, neoclassical paradigm that postulates that prices of assets must be determined by marginal utility of the investors. This simple idea has proven extremely useful in explaining numerous asset pricing facts, but many puzzles remain unsolved, or at least there is no consensus with respect to the fundamental reasons of why we observe some well-known, real-world phenomena (like value premium, or profitability of momentum strategies). Much of the recent literature focuses therefore on the extensions of the standard model, some of which are more plausible (frictions), and some less (large deviations from investor rationality). But to understand the extensions, it is crucial to know the core, and the best papers are those, which explain facts using as few departures from the neoclassical world as possible.

Textbook and Additional Reading

The course is based on *Asset Pricing (Revised)* (AP) by John Cochrane (please see below for the selection of chapters). Two other texts by the same author: *Portfolio Theory* (PT), and *Financial Markets and the Real Economy* (FMRE) will also be used. The former is on portfolio selection (not covered in the textbook), and the latter is a very good survey of asset pricing literature. The textbook does not cover the topic of consumption-based models with Long-Run Risks, which has gained considerable attention in recent years. We will learn this modeling methodology from the original paper of *Bansal and Yaron (2004)* (BY).

Evaluation

Students will be evaluated based on class attendance, activity, and paper presentations. They are not only expected to present, but actively participate in presentations by the others.

Homework

We will assign weekly homework, which won't be graded. However, solving the problems regularly will greatly increase your understanding of the concepts, and make them applicable in your own future research. Not solving exercises will lead to a loss of motivation for the course, and (with high probability) low final grade.

Tentative Course Outline

The outline is subject to changes as we go through the semester.

Topic	Reading	Dates
Consumption-Based Asset Pricing Model <ul style="list-style-type: none"> - Course Introduction - Pricing by Consumer's First-Order Conditions - Prices, Payoffs, and Notation - Classic Issues in Finance - General Equilibrium 	AP, Ch. 1-2	Oct 16, 23
Contingent Claims Markets <ul style="list-style-type: none"> - Contingent Claims - Risk-Neutral Probabilities - Risk Sharing 	AP, Ch. 3	Oct 30
The Discount Factor <ul style="list-style-type: none"> - Law of One Price - No Arbitrage 	AP, Ch. 4	Nov 6
Mean-Variance Frontier <ul style="list-style-type: none"> - Standard Derivation - Orthogonal Representation (Hansen-Richard) - Relations Between Discount Factors, Beta Representations, and the MV Frontier 	AP, Ch. 5-7	Nov 13
Factor Pricing Models <ul style="list-style-type: none"> - CAPM - APT 	AP, Ch. 9	Nov 20
Portfolio Selection <ul style="list-style-type: none"> - One-period setting - Multi-period setting - ICAPM 	PT	Nov 27
Term Structure of Interest Rates <ul style="list-style-type: none"> - Yields, Returns, Forward Rates - Yield Curve - Expectations Hypothesis - Term Structure Models 	AP, Ch. 19	Dec 4
Empirical Facts <ul style="list-style-type: none"> - Cross-Sectional Return Predictability - Time-Series Predictability 	AP, Ch. 20; FMRE	Dec 11
Consumption-Based Model Revisited <ul style="list-style-type: none"> - Habit Formation - Epstein-Zin Utility, and Long-Run Risks 	AP, Ch. 21; BY	Dec 18
Paper Presentations by Students	Paper List TBA	Jan 8 - Feb 12