



Northeastern University
Department of Economics

Financial Economics

ECON 4640

Prof. María José Luengo-Prado

Spring 2014

⌚ Monday & Wednesday 2:50-4:30pm

📍 Forsyth Building 151

⌚ **Office Hours:** Mondays: 8:30-9:15am & 11:15-11:45am
Wednesdays: 11:15-11:45am, 1:30-2:30pm & 4:45-5:15pm.
Also by appointment.

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👤 **TA:** Thomas Griffin

📍 **Office:** 310 Lake Hall

Office hours: Tuesday 2:30-3:30pm, Friday 2:00-4:00pm or by appointment.

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Course Overview

The objective of this course is to provide a rigorous framework for understanding finance and investments from the household perspective. The materials to be covered include the basics of financial markets, the time value of money, the principles of risk and return, theories of portfolio selection, valuation of stocks, bond pricing, and options (what they are and how to use them). The course is geared toward nonbusiness majors who are interested in a rigorous course in finance with emphasis on personal life-cycle finance.

Prerequisites

Macroeconomic Theory (ECON 2315) or Macroeconomic Theory (ECON 2316), and Statistics (ECON 2350).

This course builds on students' background knowledge in economics and statistics. Although efforts will be made to keep the use of advanced mathematics to a minimum, knowledge of calculus is assumed and is crucial for the understanding of the course materials. Knowledge of a spreadsheet software is a must.



Blackboard

- I use Blackboard to distribute all course materials. To use Blackboard, log in to your myNEU account. If you have officially registered for the course, it should automatically appear in your ‘My Courses’ link. If it is not the case, let me know as soon as possible.
- A Blackboard tutorial can be found under the ‘Blackboard Support’ tab (once you log in to Blackboard).
- You could also take a training class (<http://www.northeastern.edu/infoservices/>) but using Blackboard is pretty straightforward.
- In case you do not know, you can integrate Blackboard with Facebook: <http://blackboardtips.blogspot.com/2008/06/how-to-add-blackboard-to-facebook.html>
- Please, use the appropriate ‘Discussion Board’ on Blackboard to ask questions about course content, homework, etc. instead of e-mail.

Textbook and Readings

- The textbook is *Financial Economics*, second edition, by Zvi Bodie, Robert C. Merton and David L. Cleeton, Pearson Prentice Hall, 2009. (BMC hereafter).
- Consider renting your textbook or the e-book version if price is an issue. One vendor of e-books is CourseSmart but there are others, including the Northeastern Bookstore.
- I will also present some materials from *Fundamental of Investments (valuation and management)*, 5th edition, by Bradford D. Jordan and Thomas W. Miller, Jr., McGraw-Hill Irwin, 2010. (You are not required to buy this book.) http://highered.mcgraw-hill.com/sites/0073530719/student_view0/
- I will assign additional readings and make them available through Blackboard.

Course Requirements and Grades

Your grade will be based on:

Quizzes and class participation	10%
Problem sets	25%
1 Midterm Exam (Feb. 24)	25%
1 Comprehensive Final (TBA)	40%
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TOTAL	100%



The Problem Sets

The following rules apply and will be strictly enforced without exceptions:

- Homework will be posted on Blackboard and will be due on the specified date. Since problems sets will be posted well in advanced the due date, late homework will not be accepted, regardless of circumstances. The problem set with the lowest score will be dropped when calculating your grade.
- Most homework will be set up as quizzes on Blackboard and are due online. A couple of homework would be set-up as group projects. The instructor will assign you to a group.
- Homework are either automatically graded on Blackboard or by the TA. If you have complaints about the grading of a problem set, do the following: within ONE week after the answer key has been posted, hand the professor a brief written statement explaining your complaint (i.e., which question you think was graded wrongly and why). Since most homework are due online, make sure you keep a copy of your answers so that you can compare them to the answer key. If you loose your answers you may ask Prof. Luengo-Prado or the TA to print a report with the questions you got wrong, but try to keep a copy of your homework for your own records.
- You are allowed to discuss homework with other students. However, everybody has to hand in his/her own, uniquely written assignment unless the homework is a group assignment. Exams will be similar to problem sets, so you would only hurt yourself by not working out the problems and copying them from somebody else.
- In addition to homework, it is strongly recommended that you try a few of the review questions at the end of each chapter.

Midterm

There will be one in-class examination on February 24 (the date is subject to change and will be confirmed one week in advance). This exam represents 25% of your grade. There will not be make-up exams. If you skip the exam at the last minute, please be aware of the fact that, unless you were completely incapacitated, you will not be able to make up the exam nor will I weigh your final higher to adjust for the missing points. Generally, absence from an exam will be excused only for illness or valid conflicts about which you have to inform me at soon as possible. If you are excused from the midterm, the final will be worth 65% percent of your final grade.



The Final Exam

The final is a comprehensive exam and will represent 40% of your grade. The final's date is set by the university (TBA). Be advised that I will not change the exam date to accommodate students' personal travel. In case of exam conflict, please follow the university policy described at:

<http://www.northeastern.edu/registrar/finexconflict.html>

Extra Credit

Students who want to take the course material a bit further or those who are concerned about their grades can obtain extra credit by working on a project of their choosing individually or in small groups. The only constraints are that the project must be pre-approved by the instructor and that the last day to submit an extra credit is April 14 (earlier is preferred).

Keep in mind

- ⇒ An 'A' grade will be reserved for top students who demonstrate deep understanding of the material (superior to that of peers) through testing, assignments, discussions, etc.
- ⇒ Poor performance is not a valid reason for an **incomplete**. An incomplete is given only under exceptional circumstances and requires satisfactory completion of a substantial part of the course. A grade of incomplete will require a signed "contract" specifying completion arrangements. The instructor determines the legitimacy.
- ⇒ The course can be taken **Pass/Fail** by non-freshman students for whom it is not a required course. It is the student's responsibility to determine if he/she is eligible to take the course under this option. The instructor must be informed of this decision no later than two weeks before the final. Students **MUST** earn the equivalent of a C- or higher to receive a Pass grade. A contract will be signed between the student and the instructor to keep record of the request. Do not ask during or after the final exam for a Pass/Fail grade.
- ⇒ Northeastern University is committed to the principles of **intellectual honesty and integrity**. "All members of the Northeastern community are expected to maintain complete honesty in all academic work, presenting only that which is their own work in tests and assignments." (see <http://www.northeastern.edu/osccr/academicintegrity/index.html>). Students found cheating or plagiarizing will receive an "F" in the course and will be referred to the Dean of Students for appropriate action.

Class Etiquette

- **Very regular attendance is expected.** Students who are not willing to attend very regularly should drop the course. **Important:** if you accumulated more than five



absences, you cannot get a grade higher than a C.

- We will have a **short break** during each class period given the length of our course sequence.
- You are expected to be **punctual and respectful**. Cell phones off or silent, please! If you happen to arrive late for unforeseen circumstances, please wait for the break to enter the classroom.
- Please, **do not leave the classroom during lectures** unless strictly necessary as it is very distracting for both students and the instructor.
- I will ask you to bring **laptop** computers to class in some occasions. If you do not have one, you will be paired up with someone who does for in-class activities.
- Readings and homework will be assigned and announced on Blackboard. If a reading is marked as “required”, please **come to class prepared**.
- Be advise that I **could call** during lectures and I expect you to make an effort to answer questions intelligently.
- Behaviors that are **disruptive** to teaching and learning **will not be tolerated** and will be referred to the Student Conduct Program for disciplinary action.

Where to go for help

(other than the instructor who really encourages you to make use of her office hours)

- **The Teaching Assistant.** The teaching assistant for this class is Thomas Griffin who is a Ph.D. student in the economics department. He holds office hours weekly—Tuesdays 2:30-3:30pm and Fridays 2-4pm. He is also available by appointment given sufficient advance notice.
- **Blackboard.** You can post questions in the appropriate Discussion Board on Blackboard. Be specific in your headings so that your question can be quickly identified. Questions posted by 9pm will be answered by the instructor or the T.A. within a few hours. Questions posted after 9pm will typically be answered the following day, and questions posted on weekends might take longer to be answered as well. Anyone is allowed and encouraged to answer questions by classmates though!
- **Students with Special Needs.** The University will make reasonable accommodations for persons with documented disabilities. Students should notify the Disability Resource Center (located in 20 Dodge Hall) and their instructors of any special needs. Instructors should be notified the first week of classes. (See <http://www.drc.neu.edu/>.)



Feedback

If you have any concerns on how the course progresses or suggestions on how to improve the course content or classroom dynamics throughout the semester, do not hesitate to voice your ideas and/or concerns. I have set up a discussion board on Blackboard for this purpose (anonymous posting allowed).



Outline

INTRODUCTION

1. Overview of financial markets and institutions. [Chapters 1 and 2 in BMC]

TIME AND RESOURCE ALLOCATION

2. The time value of money. [Chapter 4 in BMC and instructor's notes]
3. Household savings and investment decisions. [Chapter 5 in BMC]

VALUATION MODELS

4. Principles of market valuation. [Chapter 7 in BMC]
5. Bonds [Chapter 8 in BMC and instructor's notes]
6. Stocks [Chapter 9 in BMC and instructor's notes]

RISK MANAGEMENT AND PORTFOLIO CHOICE.

7. Expected utility and risk aversion. [Instructor's notes]
8. Principles of risk management. [Chapter 10 in BMC]
9. Hedging, insuring, and diversifying. [Chapter 11 in BMC]
10. Portfolio choice. [Chapter 12 in BMC]

ASSET PRICING

11. Capital market equilibrium. [Chapter 13 in BMC]
12. Forward and future markets. [Chapter 14 in BMC]
13. Options. [Chapter 15 in BMC]

SPECIAL TOPICS (TIME PERMITTING)

14. The housing crisis, behavioral finance, etc. [Instructor's notes]