INTRODUCTION TO FINANCIAL ECONOMICS
(Economics 134)
Prof. Klaus Nehring
Fall 2002

Office: 1110 SSHB, 752-3379.
Office Hours: M 3:45-5:00 (for you), T 2:15-4:00 (for my 100 students).

Teaching Assistant: Ruojin (“Rosalin”) Wu, 129 Hunt Hall, 752-8163;
email: rjwu@ucdavis.edu.
Office Hours: T 1:30-3:30 and by appointment.

Prerequisites: Economics 100, Statistics 13. Facility with calculus is assumed.

Reading:

• Textbook (required):
  Ross, Westerfield and Jaffe, Corporate Finance, Irwin, Boston 2002 (“CF”);
  Paperback selection of relevant chapters available at bookstore.

• Reader (required, will be available at Classical Notes).
  The reader contains selected clippings from the Wall Street Journal, The Economist,
  The New York Times and Barron’s; regular reading of some of these publications is
  recommended. The clippings provide some real-world background and illustration to
  ideas and themes raised in the course. Invariably, they give a much more complex
  picture than you will get from the textbook diet. While they should help flesh out
  many things you will learn, they will also raise a lot of questions, many without readily
  available answer.

The reader also contains H. Varian’s “Intermediate Microeconomics”, ch. 13, Risky
Assets.
Highly recommended supplementary reading:

**Homework:**
There will be 7 challenging problem sets and a two-part investment exercise. The problem sets as well as the investment exercise will be partly graded. To further encourage serious work on the problem sets, each exam will contain at least one problem from an earlier homework.

**Grading:**
Your grade will be calculated as
\[
0.10 \times \text{Homework} + 0.30 \times \text{Higher Midterm} + 0.30 \times \text{Final} + 0.30 \times \text{Lower Midterm Score.}
\]
If the Final score is better than that of the lower midterm, the Final score will replace it.

*In addition, I may adjust the grade one step up if you participate regularly and reasonably intelligently.*

Late homework won’t be accepted, nor make-up exams be given, unless you provide a written medical excuse; nor will early or late exams be given.

**Discussion Sections:**
Ruojin Wu, the TA for this course, will lead the discussion sections (R 6-7 and R 7-8, Wellman 230). Ruojin will help you get started on the problem sets and review them afterwards. *You are expected to come regularly to one of the discussion sections, for otherwise you may have a very hard time doing the homework.*

**Probable Exam Dates:**
- Midterms: Friday, October 25; Friday, November 15
- Final: Friday, December 13.
COVERAGE

Week 1. INTRODUCTION
- CF, ch. 1.
- “Living in Freefall”, The Economist, November 18, 2000
- “Finance: Trick or Treat?”, The Economist, October 23, 1999.

FOUNDATIONS OF INTERTEMPORAL FINANCE
- CF, ch. 3.

Week 2. NET PRESENT VALUE
- CF, ch. 4

Week 3. HOW TO VALUE STOCKS
- CF, ch. 5.4-5.9.
- “Shares without the Other Bit”, The Economist, November 20, 1999.

Week 4. HOW TO VALUE BONDS
- CF, ch. 5.1-5.3, Appendix (p. 130-132).

INVESTMENT RULES
- CF, ch. 6, sections 1,2,5,6,8.
Week 5. CAPITAL MARKET THEORY: AN OVERVIEW
- CF, ch. 9.
- “Stop This Dream”, July 20, 2002.

Week 6. INVESTING UNDER RISK: THE MEAN-VARIANCE APPROACH

Weeks 7-9. MANY RISKY ASSETS: THE CAPITAL-ASSET-PRICING MODEL
- CF, ch. 10.
- “All Fall Down”, The Economist, November 8, 1997.
- “Safety in Numbers?”, The Economist, February 27, 1999.
- “All-Tech All the Time Tells Only One Side of the Story”, NYT, March 9, 2000.
Week 10. EFFICIENT CAPITAL MARKETS

- CF, ch. 13.


- “Tales from the FAR Side”, The Economist, November 16, 1996.