Objective

This course provides a theoretical framework to analyze macro-finance market behavior. To highlight the features of each market, the entire financial system is structured into four markets: money, bond, stock, and foreign exchange. The domestic markets are linked through Fisher equation, term structure of interest rates, and CAPM. International markets are linked through various international parity conditions. Economic fundamentals provide the rationale for determination of asset prices (returns). Recent studies in behavioral models also shed some lights on the pricing process. In addition to theoretical expositions, some empirical issues and evidence will be discussed.

Grading

- One Final Comprehensive Exam (including reading assignments and lectures) - 40%.
- One term paper – 50%. (The paper is restricted to macrofinance area. It should be submitted in written form in a professional style. You are required to present the paper in the last session of the class. You also serve as a discussant to discuss your classmate’s paper. Some original and preliminary empirical results are expected).
- Presentation and critics in class – 10%

Text Books


Useful Books


Campbell, J.Y. articles in Web site: http://ideas.repec.org/e/pca54.html

Fama, E. articles in Web site: http://www.lib.uchicago.edu/e/busecon/busfac/Fama.html
1. Financial Markets

A. Basic Concepts in Finance

Cochrane, J. “Consumption-Based Model,” Ch. 1.

B. Money and Financial Assets

McCallum, B.T. “Demand for Money” in Monetary Economics, Chs. 3, 4


C. Money Announcements and Asset Prices

2. Bond Markets and Interest Rate
   A. Basic Concepts and Valuation of Bonds
      (The above website contains information comparable to our lecture)
      Cuthbertson, “Bond Prices and the Term Structure of Interest Rates,” Ch. 9.
   B. Term Structure of Interest Rates
      Sargent, T. “Asset Prices and Consumption,” Dynamic Macroeconomic Theory,
      Ch. 3, 92-106.
      Cuthbertson & Nitzche, “Theories of the Term Structure,” Ch. 20.
   C. Information Content of Yield Curve
      Harvey, C.R. “Forecasts of Economic Growth from the Bond and Stock Markets,”
      Fama, E. F. “Short-Term Interest Rates as Predictors of Inflation,” Ch. 6 in
      Shiller, R. J. and J.J. Siegel. “The Gibson Paradox and Historical Movements in Real
      Harvey, C.R. “The Real Term Structure and Consumption Growth,” Journal of
   D. Empirical Evidence of Interest Rates
      Chiang, T.C., “Time Series Dynamics of Short-Term Interest Rates - Evidence
      from Euro-Currency Markets,” Journal of International Financial Markets,
      Institutions & Money, 7, October 1997, 201-220.
      Investigation of Alternative Models of the Short-term Interest Rate,” Journal
      http://www.cob.ohio-state.edu/fin/faculty/karolyi/papers/CKLS.pdf
      Bliss, R.R. and Smith, D.C., “The Elasticity of Interest Rate Volatility: Chan,
      Karolhi, Longstaff, and Sanders Revisited,” Federal Reserve Bank of Atlanta,

3. Stock Markets
   A. Valuation


Thomas, J.K. 2005, Price equals forward earnings scaled by the risk-free rate: the implications of this remarkable empirical regularity, Yale working paper.

[http://w4.stern.nyu.edu/emplibrary/P8_Price_equals_forward_earnings_scaled_by_the_risk_free_rate.pdf](http://w4.stern.nyu.edu/emplibrary/P8_Price_equals_forward_earnings_scaled_by_the_risk_free_rate.pdf)


**B. Consumption-CAPM**

Cuthbertson & Nitzche, Ch. 13.

**C. The Efficient Markets Hypothesis**

Fama, E. “Efficient Capital Markets” Ch. 5 in *Foundation of Finance*, 1976.

Cuthbertson & Nitzche, Ch. 3,


**D. Predictability in Stock Returns and Anomalies**

Cuthbertson & Nitzche, Ch. 4.

* Chiang, Forcasting by ARIMA(FIN642Lecture5&6). PSW: FIN642W


Cuthbertson & Nitzche, pp. 433-447.


E. Empirical Analysis


http://kuznets.fas.harvard.edu/~campbell/papers/vrupdate.pdf

4. Foreign Exchange Markets

A. Foreign Exchange Markets and International Parity Conditions

Cuthbertson & Nitzche, Chs. 24-25.


B. International Capital Markets


5. Risk Premium and Volatility

A. Financial Market Volatility

Cuthbertson & Nitzche, “Volatility and Market” Ch. 29.


**B. Equity Premium Puzzles**

Cuthbertson & Nitzche, Ch. 14, 323-332.


* Cochrane, J.H., “Equity Premium Puzzle and Consumption-Based Models,” Ch. 21 in *Asset Pricing*.


**C. Conditional Variance Models and Risk Premium**

* Stock Market*


* Foreign Exchange and International Markets*

Cuthbertson & Nitzche, Ch. 26


**Bond Markets**


**D. Comovements**


**6. Behavioral Models**

Cuthbertson & Nitzche, Ch. 19.


7. High Frequency Data in Financial Markets


* denotes optional reading.