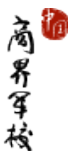




PHBS

北京大学汇丰商学院



ECON570 / FIN525 Financial Economics II Module 4, Year 2017-2018

Course Information

Instructor: Sungbin Sohn

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Office Hour: Tuesdays 1-2pm & Fridays 3-4pm

Teaching Assistant:

Phone: TBA

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Classes:

Lectures: Tuesdays and Fridays, 8:30-10:20am

Venue: PHBS Building, Room 209

1. Course Description

1.1 Context

Course overview: This course studies the topics in finance in an advanced level. It begins with the brief review of expected utility and risk aversion, and covers static portfolio choice problems and the basics of asset pricing theory (SDF, Euler equation, complete/incomplete market, volatility bound, etc.). The course then turns to the capital asset pricing model (CAPM), discusses its anomalies and limitations, and presents its extensions such as inter-temporal CAPM, conditional CAPM, consumption-based model, and multi-factor models. The course also develops dynamic portfolio choice problems and equilibrium asset pricing theories, and discusses famous puzzles in finance (equity premium puzzle, risk-free rate puzzle, volatility puzzle, etc.) and their suggested solutions. Finally, the course covers the basics of market microstructure and behavioral asset pricing. The emphasis of the course is theoretical, but empirical applications (using US and Chinese data) are also covered.

Prerequisites: You are assumed to have already taken Financial Economics I (ECON569/FIN520) and to have knowledge of master-level microeconomics and undergrad-level econometrics.

1.2 Textbooks and Reading Materials

The textbook for the course is

John H. Cochrane (2001), *Asset Pricing*, Princeton University Press.

In addition, lecture notes and the suggested reading list are provided.

2. Learning Outcomes

2.1 Intended Learning Outcomes

Learning Goals	Objectives	Assessment
1. Our graduates will be effective communicators.	1.1. Our students will produce quality business and research-oriented documents.	No
	1.2. Students are able to professionally present their ideas and also logically explain and defend their argument.	Yes: by presenting and evaluating academic papers
2. Our graduates will be skilled in team work and leadership.	2.1. Students will be able to lead and participate in group for projects, discussion, and presentation.	Yes: by preparing the group presentation
	2.2. Students will be able to apply leadership theories and related skills.	No
3. Our graduates will be trained in ethics.	3.1. In a case setting, students will use appropriate techniques to analyze business problems and identify the ethical aspects, provide a solution and defend it.	No
	3.2. Our students will practice ethics in the duration of the program.	No
4. Our graduates will have a global perspective.	4.1. Students will have an international exposure.	Yes: by learning empirical findings in foreign countries
5. Our graduates will be skilled in problem-solving and critical thinking.	5.1. Our students will have a good understanding of fundamental theories in their fields.	Yes: by studying various theories
	5.2. Our students will be prepared to face problems in various business settings and find solutions.	No
	5.3. Our students will demonstrate competency in critical thinking.	Yes: by completing problem sets

2.2 Course specific objectives

In the end of the module, students are expected to have insights and intuitions about global financial phenomena and to be able to critically think in various economic situations. See the course outline for details.

2.3 Assessment/Grading Details

Requirements for the course include attending lectures, several problem sets, a group presentation, a midterm exam and a final exam.

1. Attendance: Since the course is cumulative in the sense that each lecture builds on previous ones, full attendance is required. I take roll randomly throughout a module. If you're absent without my pre-approval, your course grade will be negatively affected.
2. Homework assignments: You are encouraged to work in groups. However, you must turn in an individual solution. Some of the assignments could contain computational exercises. Late submission is unacceptable and will not be graded. The solution is to be provided for each homework assignment.
3. Group presentation: I will ask you to choose your preferred topics. Then, several groups are formed based on your preference. Students in each group read and understand the paper, and present it to your classmates. Each presentation is expected to be 25-minute long (including Q&A's) and should contain the summary of the paper and your own critical assessment.
4. Exams: Exams test whether you are skilled in problem-solving and critical thinking. Past exams are provided for your reference.

The grading of the course is broken down to the following components:

Homework assignments	20%	
Attendance and paper presentation	20%	June 26 (in class) and 27 (1:30-3:20pm)
Midterm exam	30%	June 5, in class
Final exam	30%	July 6 (9-11am) Location TBA

2.4 Academic Honesty and Plagiarism

It is important for a student's effort and credit to be recognized through class assessment. Credits earned for a student work due to efforts done by others are clearly unfair. Deliberate dishonesty is considered academic misconducts, which include plagiarism; cheating on assignments or examinations; engaging in unauthorized collaboration on academic work; taking, acquiring, or using test materials without faculty permission; submitting false or incomplete records of academic achievement; acting alone or in cooperation with another to falsify records or to obtain dishonestly grades, honors, awards, or professional endorsement; or altering, forging, or misusing a University academic record; or fabricating or falsifying of data, research procedures, or data analysis.

All assessments are subject to academic misconduct check. Misconduct check may include reproducing the assessment, providing a copy to another member of faculty, and/or communicate a copy of this assignment to the PHBS Discipline Committee. A suspected plagiarized document/assignment submitted to a plagiarism checking service may be kept in its database for future reference purpose.

Where violation is suspected, penalties will be implemented. The penalties for academic misconduct may include: deduction of honour points, a mark of zero on the assessment, a fail grade for the whole course, and reference of the matter to the Peking University Registrar.

For more information of plagiarism, please refer to *PHBS Student Handbook*.

3. Topics, Teaching and Assessment Schedule

The references and the schedule of topics are likely to be updated as the course evolves.

Lecture 1-2: Introduction; Expected utility and risk aversion; Portfolio choice under uncertainty

- Cochrane, Chapter 1, 2, 3.
- Mas-Colell, Winston and Green (1995), *Microeconomic Theory*, Oxford University Press, Chapter 6.
- Summers, Lawrence (1985), "On Economics and Finance," *Journal of Finance* 40.
- Wachter, Jessica A., and Motohiro Yogo (2010), "Why Do Household Portfolio Shares Rise in Wealth?," *Review of Financial Studies* 23.

Lecture 3-4: Euler equation and the stochastic discount factor; Complete/incomplete markets; Volatility bounds

- Campbell, John Y. (2003), "Consumption Based Asset Pricing," in George Constantinides, Milton Harris and Rene Stulz eds., *Handbook of the Economics of Finance*, North-Holland, Amsterdam.
- Cochrane, Chapter 4, 5, 6, 7, 8.
- Cochrane, John H. (1991), "A Simple Test of Consumption Insurance," *Journal of Political Economy* 99.
- Hansen, Lars P. and Ravi Jagannathan (1991), "Implications of Security Market Data for Models of Dynamic Economies," *Journal of Political Economy* 99.
- Mankiw, N. Gregory and Stephen P. Zeldes (1991), "The Consumption of Stockholders and Nonstockholders," *Journal of Finance* 29.

Lecture 5-6: Mean-variance frontier; Factor pricing models and the CAPM; Equivalence of three representations; Cross-sectional asset pricing; Anomalies; Multi-factor model

- Campbell, John Y. and Tuomo Vuolteenaho (2004), "Bad Beta, Good Beta," *American Economic Review* 94.
- Campbell, John Y, Christopher Polk, and Tuomo Vuolteenaho (2009), "Growth or Glamour? Fundamentals and Systematic Risk in Stock Returns," *Review of Financial Studies* 22.

- Cochrane, Chapter 9, 10, 11, 12 and 20.2
- De Bondt, Werner F. M., and Richard Thaler (1985), "Does the Stock Market Overreact?," *Journal of Finance* 40.
- Fama, Eugene and Kenneth R. French (1996), "Multifactor Explanations for Asset Pricing Anomalies," *Journal of Finance* 51.
- Fama, Eugene and Kenneth R. French (2004), "The Capital Asset Pricing Model: Theory and Evidence," *Journal of Economic Perspectives* 18.
- Jagannathan, Ravi, and Yong Wang (2007), "Lazy Investors, Discretionary Consumption, and the Cross-section of Stock Returns," *Journal of Finance* 62.
- Lakonishok, Josef, Andrei Shleifer, and Robert Vishny (1994), "Contrarian Investment, Extrapolation and Risk," *Journal of Finance* 49.

Lecture 7-8: Limitation of CAPM; Inter-temporal CAPM; Conditional factor model; Human capital CAPM

- Campbell, John Y (1993), "Intertemporal Asset Pricing without Consumption Data," *American Economic Review* 83.
- Campbell, John Y (1996), "Understanding Risk and Return," *J. of Political Economy* 104
- Epstein, Lawrence and Stanley Zin, (1989), "Substitution, Risk Aversion, and the Temporal Behavior of Consumption and Asset Returns: A Theoretical Framework," *Econometrica* 57.
- Fama, Eugene and Kenneth R. French (1997), "Industry Cost of Equity," *Journal of Financial Economics* 43.
- Weil, Philippe (1994), "Nontraded assets and the CAPM", *European Economic Review* 38.

Midterm

Lecture 9-10: Present value relationships; Stock return predictability; Dynamic choice of portfolio and consumption; General equilibrium model; Production-based asset pricing model

- Campbell, John Y and Robert J. Shiller (1988), "The Dividend-Price Ratio and Expectations of Future Dividends and Discount Factors," *Review of Financial Studies* 1.
- Campbell, John Y and Robert J. Shiller (1998), "Valuation Ratios and the Long-Run Stock Market Outlook," *Journal of Portfolio Management* 24.
- Cochrane, Chapter 20.1
- Cochrane, John H. (1991), "Explaining the Variance of Price-Dividend Ratios," *Review of Financial Studies* 5.
- Hou, Kewei, Chen Xue, and Lu Zhang (2014), "Digesting Anomalies: An Investment Approach," *Review of Financial Studies* 27.
- Liu, Laura Xiaolei, Toni M. Whited, and Lu Zhang (2009), "Investment-Based Expected Stock Returns," *Journal of Political Economy* 117.
- Lucas, Robert E. (1978), "Asset Prices in an Exchange Economy," *Econometrica* 46.
- Stokey, Nancy L. and Robert E. Lucas Jr., with Edward C. Prescott (1989), *Recursive Methods in Economic Dynamics*, Harvard University Press.
- McGrattan, Ellen R. and Edward C. Prescott (2003), "Average Debt and Equity Returns: Puzzling?," *American Economic Review* 93.
- Mehra, Rajnish and Edward C. Prescott (1985), "The Equity Premium: A Puzzle," *Journal of Monetary Economics* 15.
- Shiller, Robert J. (1981), "Do Stock Prices Move Too Much to be Justified by Subsequent Changes in Dividends?," *American Economic Review* 71.

Lecture 11-12: Suggested solutions to puzzles

- Ait-Sahalia, Yacine, Jonathan A. Parker, and Motohiro Yogo (2004), "Luxury Goods and the Equity Premium," *Journal of Finance* 59.
- Bansal, Ravi and Amir Yaron (2004), "Risks for the Long Run: A Potential Resolution of Asset Pricing Puzzles," *Journal of Finance* 59.
- Barro, Robert (2006), "Rare Disasters and Asset Markets in the Twentieth Century," *Quarterly Journal of Economics* 121.
- Campbell, John Y. and John H. Cochrane (1999), "By Force of Habit: A Consumption-Based Explanation of Aggregate Stock Market Behavior," *J. of Political Economy* 107.

- Constantinides, George M. and Durrell Duffie (1996), "Asset Pricing with Heterogeneous Consumers," *Journal of Political Economy* 104.
- Grossman, Sanford J. and Guy Laroque (1990), "Asset Pricing and Optimal Portfolio Choice in the Presence of Illiquid Durable Consumption Goods," *Econometrica* 58.
- Vissing-Jorgensen, Anette (2002), "Limited Asset Market Participation and the Elasticity of Intertemporal Substitution," *Journal of Political Economy* 110.

Lecture 13-15: Information aggregation and market microstructure; Behavioral finance and limits to arbitrage

- Cohen, Lauren, Andrea Frazzini and Christopher Malloy (2008), "The Small World of Investing: Board Connections and Mutual Fund Returns," *J. of Political Economy* 116.
- Grossman, Sanford and Joseph Stiglitz (1980), "On the Impossibility of Informationally Efficient Markets," *American Economic Review* 70.
- Stein, Jeremy (2008), "Conversations among competitors," *American Econ. Review* 98.
- Abreu, Dilip and Markus Brunnermeier (2003), "Bubble and Crashes," *Econometrica* 71.
- DeLong J. Bradford, Andrei Shleifer, Lawrence Summers and Robert Waldmann (1990), "Noise Trader Risk in Financial Markets," *Journal of Political Economy* 98.
- Froot, Kenneth A., Emil Dabora (1999), "How are Stock Prices Affected by the Location of Trade?," *Journal of Financial Economics* 53.
- Hong, Harrison and Jeremy Stein (1999), "A Unified Theory of Underreaction, Momentum Trading and Overreaction in Asset Markets," *Journal of Finance* 54.
- Shleifer, Andrei and Robert Vishny (1997), "The Limits of Arbitrage," *J. of Finance* 52.

Paper presentations

If time permits: Micro evidence about consumption and portfolio choice; Mortgage backed securities

- Ameriks, John, Andrew Caplin and John Leahy (2003), "Wealth Accumulation and the Propensity to Plan," *Quarterly Journal of Economics* 118.
- Calvet, Laurent E., John Y. Campbell, and Paolo Sodini (2007), "Down or Out: Assessing the Welfare Costs of Household Investment Mistakes," *Journal of Political Economy* 115.
- Diamond, Douglas W. and Phillip H. Dybvig (1983), "Bank Runs, Deposit Insurance, and Liquidity," *Journal of Political Economy* 91.
- Hurst, Erik, "Grasshoppers, Ants, and Pre-Retirement Wealth: A Test of Permanent Income Consumers," *NBER Working Paper No. 10098*.
- Johnson, David S., Jonathan A. Parker and Nicholas S. Souleles, "Household Expenditure and the Income Tax Rebates of 2001," *NBER Working Paper No. 10784*.

4. Miscellaneous

I encourage you to ask questions during lectures and office hours. If you have special needs to reach me outside the lectures or office hours, however, feel free to email me. I usually respond to your email in two business days, but if you don't get my response within two business days, please send me a reminder. When you email me, please prefix the subject header of [FEII].