

Instructor: James McDermott, Ph.D.
Jmcderm4@gmu.edu
Class Schedule: Monday, 4:30 to 7:10; Robinson B228
Office hours: Monday, 3:30 to 4:40, Mason D150 or by
appointment.

Course objectives: The objectives for this course are for you to understand (1) key hypotheses regarding the functioning of financial markets (e.g., the Capital Asset Pricing Model and the Efficient Market Hypothesis); (2) the limitations of these models; (3) the performance of these models during the recent market crash and recession; and (4) recent critiques of these models and the search for alternatives (including behavioral finance).

Course description: The course will address the following topics: A brief overview of the U.S. and international financial system and the role of different financial institutions; a survey of financial economics, focusing on the leading models such as the Capital Asset Pricing Model; examples of risks outside the purview of these models; the performance of these models during the recent market crash; and challenges to those leading models, including behavioral finance, and the search for alternatives.

Texts and reading assignments:

Required: Zvi Bodie, Alex Kane and Alan Marcus (BKM), *Elements of Investments*
Wall Street Journal

Reading assignments in BKM are based on the current (9th) edition; some problems in the homework assignments are slightly different than in earlier editions but there are ways to address this. There may be an international version of the 9th edition that is identical in content (but less expensive). You can order the *Wall Street Journal* with a student discount at <http://www.wsj.com/studentoffer>, but you are free to use any source. The syllabus does not have specific *WSJ* reading assignments; several will be announced in class, and you are encouraged to read the *WSJ* independently to follow developments in today's fluid financial markets. Assigned readings from the *Journal of Economic Perspectives* (JEP) are on the course schedule and are available through the University Library's access to JSTOR. I may add or replace JEP articles during the semester.

Class format and expectations: The course is primarily a lecture course, but I strongly encourage your questions and discussion. Attending class and preparing by reading the assigned material prior to class are keys to effective class participation, which can benefit grades in borderline situations. If you miss a class, you are responsible for the information presented, including the

course content, assignments, and any announcements. You can get this information from other students. Please contact me if you have questions.

Please turn cell phones, iPods, pagers, etc. off and refrain from checking email, etc. during class.

There will be several short assignments throughout the first half of the semester; the goal of the assignments is for you to see how the models are “supposed to work,” using actual data. If you have general familiarity with Excel or similar programs, that will help you complete the assignments. If you’re not familiar with spreadsheet programs, developing some familiarity is a good resume line and assistance is available through the Student Technology Assistance and Resource Center (STAR) (<http://media.gmu.edu/starworks/works.html>).

Course requirements and grading: Scores on the assignments, two short quizzes, a midterm exam, and a final exam will determine student grades for the course. As noted above, effective class participation can benefit grades in borderline situations. The exams will cover both reading assignments and lecture material. Make-up exams are limited to (1) unusual circumstances and arrangements made prior to the exam or (2) a documented emergency (e.g., severe illness). Assignments are to be handed in at the beginning of the class when they are due; there is no credit for missed assignments.

Final grades will be based on:

Assignments:	15%	Quizzes (combined)	15%
Midterm exam:	30%	Final exam:	40%

Honor code: GMU is an Honor Code university; please see the [Office for Academic Integrity](#) for a full description of the code and the honor committee process. The principle of academic integrity is taken very seriously. What does academic integrity mean in this course? Essentially this: when you are responsible for a task, you will perform that task. Assignments in this class are individual assignments. You are welcome to discuss the assignment with others in the class, but the work you hand in must be your own. Another aspect is the free play of ideas. Vigorous discussion and debate are encouraged in this course, with the expectation that all aspects of the class will be conducted with civility and respect for differing ideas, perspectives, and traditions. When in doubt (of any kind), please ask for guidance and clarification.

Disability Resource Center: If you are a student with a disability and you need academic accommodations, please see me and contact the Disability Resource Center (DRC) on 703-993-2474. All academic accommodations must be arranged through that office.

Other: Please note that you are responsible for the accuracy of your schedule, and that you should check “PatriotWeb” regularly to verify your registration. Also, University policy states that Mason uses on Mason email accounts to communicate with enrolled students and that students must activate and use their email accounts to receive important University information, including messages related to this class. Please see <http://masonlive.gmu.edu> for more information.

In the attached reading assignments, please note that

- “JEP” assignments refer to the *Journal of Economic Perspectives* articles in the bibliography. These are available through the University Library’s access to JSTOR.
- The syllabus is preliminary and subject to change if additional time is needed to develop important topics. (I’ll discuss this during the first class session.)

Preliminary Course Schedule:

Topic	Scheduled Date	Readings
Overview of financial institutions and markets	1/25	BKM Ch. 1 through 4
Risk and return	2/1	BKM, Ch. 5 and 6
Last date to add	2/2	
CAPM and EMH	2/8-15	BKM, Ch. 7 and 8 Malkiel, JEP Fama and French, JEP Perold, JEP
Bonds	2/22	BKM, 10 and 11
Last drop date	2/19	
Derivatives and Black-Scholes	2/29 and 3/14	BKM, ch. 15 through 17 Stulz, JEP 18(3) Jarrow, JEP
Spring break	3/7	
Mid-term	3/21	
Operational risk	3/28	Duffie, JEP
Securitization	4/4	Coval et al. JEP Stulz, JEP 21(2)
Hedge funds	4/11	Edwards, JEP
2008 wasn't a very good year	4/18	Cacperczyk and Schnabl JEP Krishnamurthy JEP Stulz JEP 24(1)
Systemic risk and black swans	4/25	National Academy of Science publications (web sites and specific reading assignments will be announced in class) Black swan concept: TBD
Behavioral finance	5/2	BKM Ch. 9 Schiller JEP Baker and Wurgler JEP Hong and Stein JEP
University reading day	5/3	
Final exam	5/9 4:30–7:15	

Bibliography

- M. Baker and J. Wurgler, "Investor Sentiment in the Stock Market," *Journal of Economic Perspectives* 21(2) Spring 2007 pp. 129-151
- J. Coval, J. Jurek and E. Stafford, "The Economics of Structured Finance," *Journal of Economic Perspectives*, 23(1) Winter 2009, pp. 3-26
- D. Duffie, "The Failure Mechanics of Dealer Banks," *Journal of Economic Perspectives* 24(1) Winter 2010 pp. 51-72
- F. Edwards, "Hedge Funds and the Collapse of Long-Term Capital Management," *Journal of Economic Perspectives*, 13(2) Spring 1999 pp. 189-210
- E. Fama and K. French, "The Capital Asset Pricing Model: Theory and Evidence," *Journal of Economic Perspectives* 18(3) Summer 2004 pp. 25-46
- H. Hong and J. Stein, "Disagreement and the Stock Market," *Journal of Economic Perspectives* 21(2) Spring 2007 pp. 109-128
- M. Kacperczyk and P. Schnabl, "When Safe Proved Risky," *Journal of Economic Perspectives* 24(1) Winter 2010 pp. 29-50
- A. Krishnamurthy, "How Debt Markets Have Malfunctioned in the Crisis," *Journal of Economic Perspectives* 24(1) Winter 2010 pp. 3-28
- R. Jarrow, "In Honor of the Nobel Laureates Robert C. Merton and Myron S. Scholes," *Journal of Economic Perspectives*, 13(4) Fall 1999, pp. 229-248
- B. Malkiel, "The Efficient Market Hypothesis and Its Critics," *Journal of Economic Perspectives* 17(1) Winter 2003 pp. 59-82
- A. Perold, "The Capital Asset Pricing Model," *Journal of Economic Perspectives* 18(3) Summer 2004 pp. 3-24
- R. Shiller, "From Efficient Markets Theory to Behavioral Finance," *Journal of Economic Perspectives* 17(1) Winter 2003 pp. 83-104
- R. Stulz, "Should We Fear Derivatives?" *Journal of Economic Perspectives* 18(3) Summer 2004 pp. 173-192
- R. Stulz, "Hedge Funds: Past, Present and Future," *Journal of Economic Perspectives* 21(2) Spring 2007, pp. 175-194
- R. Stulz, "Credit Default Swaps and the Credit Crisis," *Journal of Economic Perspectives* 24(1) Winter 2010 pp. 73-92