BOSTON COLLEGE
Department of Economics

ECON3380.01
Capital Markets
Spring 2016
Stokes 295S, TTh10:30

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Prerequisites: Statistics (Ec. 151 or 155) and Micro Theory (Ec. 201 or 203)

Course Requirements and Grading:
Two midterm exams (20% apiece), February 23 and April 7
An investment research report (20%), Part I due March 22 and the complete report on May 3
A final exam (40%), on Tuesday, May 10, at 9:00 a.m.
Problem Sets in the first part of the course (optional but strongly encouraged)

Course Organization and Expectations:
The course works best if pursued as a joint enterprise where the student contributes as much as
the instructor. I expect to work hard at the course and I expect as much from you. This means coming to
class, reading the assigned materials, working through the problem sets, and raising questions on material
you find difficult or confusing. You will find me available outside of class, with sign-up times for
appointments posted outside my door, and you will find me more than willing to help if you are doing your
share as well. I also expect you to read the financial pages of the newspaper and to generate discussion
on current topics as they develop.

You are encouraged to work together on the problem sets if you like, to discuss your investment
reports with each other, and to study together. Your work on exams is to be entirely your own, and on
your investment report anything drawn from others or worked out in conjunction with others should be
carefully cited. Be sure you are familiar with the Boston College policy on "Academic Integrity" as stated
online at BCInfo (A-Z index, Academic Integrity), and be aware that I take this most seriously.

There will be no make-up exams. If you miss an exam for good reason, let me know immediately by
email or phone and you will be graded on the other exam and the final. If you do poorly on one mid-term but
consistently well on the other one and the final, the one poor exam will be discounted but not completely
ignored. (One poor midterm will reduce your grade by at most one notch, from B+ to B for example).

The problem sets and your record of attendance will be used for additional evidence up to one
notch on your grade. If your problem sets are much better than your exam grades and if your class
attendance is excellent, then your grade will be raised one notch. If they are good but about the same as
exam grades, then if you are on the borderline, they will pull you up. In no case will I grade you below what
I see on the exams and the investment project.

I want you to follow current press reports on developments in financial markets. Raise questions in
class and/or approach me after class. The course will be much more meaningful if we follow current policy
issues and then look at them in terms of the analytical apparatus developed throughout the course.

For the investment report, you are to select a firm whose stock is publicly traded, find out as much
as you can about the firm, and then arrive at a buy, hold, or sell recommendation. There is a good deal of
economic analysis involved in this, but if you pick a firm that really interests you it will be fun and will be a
great learning experience. I will give you more information on this as we go along.

Good luck. It should be fun.
Syllabus

**Topics**

I. **Introduction.**

A. Capital theory and tradeoffs over time. Notes, Introduction
B. Financial markets and economic efficiency. Notes, Chs. 1-2
C. Discounting, present value, and compound interest arithmetic. Notes, Ch. 3
D. Present value and internal rate of return Notes, Chs. 4-5
E. An introduction to speculative booms and busts Malkiel, Chs. 1-4

II. **Investment Criteria and Pricing of Assets.**

A. Rate of return: an application to yield to maturity on a bond. Notes, Chs. 6-7
B. Valuation: an introduction to common stock pricing models. Malkiel, Ch. 5, Notes, Chs. 8-12
C. Leverage, risk, and asset bubbles

**First Exam (February 23) Covers Sections I and II**

III. **Accounting Problems: Measurement of Earnings and Rate of Return.**

A. Financial statements. Notes, Ch. 13
B. The importance and use of earnings data. Notes, Ch. 14
C. Depreciation, intangibles, and earnings bias. Notes, Ch. 15-16
D. Current issues in measurement and reporting. Notes, Ch. 17

IV. **Financial Markets.**

A. Investment banking, securities exchanges, the declining role of the specialist Notes, Ch. 18-19
B. Investment strategies: fundamentalists, technicians, and random walk. Malkiel, Chs. 6-7, Notes, Ch. 20
C. The efficient market hypothesis, and some apparent inconsistencies Malkiel, Ch. 11, Notes, Chs. 21-22
D. Tobin's "q" and long-term reversals Notes, Ch. 23

**Second Exam (April 7) Covers Sections III and IV**

V. **Portfolio Selection.**

A. Diversification and risk reduction. Malkiel, Chs. 8-10, Notes, Ch. 24-25
B. The Sharpe-Lintner model. Notes, Ch. 26
C. The Capital Asset Pricing Model. Notes, Ch. 27
D. Beta as a Measure of Risk Notes, Ch. 28
E. The Pursuit of Alpha Notes, Ch. 29
F. Market Equilibrium and Asset Bubbles Notes, Chs. 30-33

**Final Exam (May 10 at 9:00 a.m.) Covers the Course**