ECON3107 / ECON5106  
Economics of Finance

Course Outline  
Semester 1, 2016

Part A: Course-Specific Information

Students are also expected to have read and be familiar with **Part B Supplement to All Undergraduate Course Outlines.** This contains Policies on Student Responsibilities and Support, Including Special Consideration, Plagiarism and Key Dates. It also contains the BUSINESS SCHOOL PROGRAM LEARNING GOALS.
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1 STAFF CONTACT DETAILS

Lecturer-in-charge: Valentyn Panchenko
Room: BUSINESS SCHOOL 440
Phone No: 9385 3363
Email: v.panchenko@unsw.edu.au

Consultation Times: Wednesday 13:00 - 14:00
Thursday 17:00 - 18:00
(or by appointment)

A full list of tutors will be posted on Course Website.

1.1 Communication with staff

You should feel free to contact your lecturer or tutor about any academic matter. However, I strongly encourage, for efficiency, all enquiries about the subject material be made at lectures or tutorials or during consultation times.

It is also (strongly) preferable that you use an UNSW email address. University policy stipulates a preference for these email addresses.

If you have a question regarding tutorials, please, contact your tutor. Email your tutor if you wish to arrange a consultation.

2 COURSE DETAILS

2.1 Teaching Times and Locations

Lectures start in Week 1 (to Week 12): The Time and Location are:
THU 14:00 – 16:00 Ainsworth Theatre G03.

Tutorials start in Week 2 (to Week 13). A full list of tutorials, times and tutors will be on the Course Website. See http://www.timetable.unsw.edu.au/current/ECON3107.html.

2.2 Units of Credit

The course is worth 6 units of credit.
This course is taught in parallel to both undergraduate and postgraduate students.

2.3 Summary of Course

The valuation formulas used throughout the modern financial world are based on the economic theory of financial markets and general equilibrium. This course provides a treatment of the economic foundations of modern finance. We start with a discussion of how economics agents (should) make decisions when the economic environment is uncertain. Then, asset-pricing models are introduced, and we discuss how economic uncertainty can be dealt with using state-contingent securities, which in turn lead to efficient market outcomes when markets are complete. Further topics include option pricing, determination of firms' value and its relation to a firm's capital structure, and the theory of efficient portfolios. The tools and knowledge that students acquire in this course are particularly useful and sought after in the public and private finance sector.
2.4 Relationship to Other Courses

This course is offered as part of the financial economics major in the Bachelors of Commerce and Economics and several streams in the Master of Commerce. Because ECON2101 (Microeconomics II) provides an introduction to neoclassical economic analysis, for undergraduate students it is a natural prerequisite for ECON3107. ECON2112 (Game Theory and Business Strategy) is an alternative prerequisite for this course.

2.5 Student Learning Outcomes

The Course Learning Outcomes are what you should be able to DO by the end of this course if you participate fully in learning activities and successfully complete the assessment items.

The Learning Outcomes in this course also help you to achieve some of the overall Program Learning Goals and Outcomes for all undergraduate coursework students in the Business School.

Program Learning Goals are what we want you to BE or HAVE by the time you successfully complete your degree. You demonstrate this by achieving specific Program Learning Outcomes - what you are able to DO by the end of your degree.

For more information on the Undergraduate Program Learning Goals and Outcomes, see Part B of the course outline.

The following table shows how your Course Learning Outcomes relate to the overall Program Learning Goals and Outcomes, and indicates where these are assessed:

<table>
<thead>
<tr>
<th>Program Learning Goals and Outcomes</th>
<th>Course Learning Outcomes</th>
<th>Course Assessment Item</th>
</tr>
</thead>
<tbody>
<tr>
<td>This course helps you to achieve the following learning goals</td>
<td>On successful completion of the course, you should be able to:</td>
<td>This learning outcome will be assessed in the following items:</td>
</tr>
<tr>
<td>1 Knowledge</td>
<td>Explain standard asset pricing models, their underlying assumptions, and their usefulness in financial decision making.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Explain the principles underlying the pricing of new financial assets whose payoffs are contingent on certain outcomes.</td>
<td>Assignments (AOL)</td>
</tr>
<tr>
<td></td>
<td>Apply programming tools such as MATLAB to real world derivative pricing.</td>
<td>Midsession exam (AOL)</td>
</tr>
<tr>
<td></td>
<td>Assess the factors that should be brought to bear to assess the value (or price) of a newly introduced asset whose payoffs are contingent on certain outcomes</td>
<td>Final exam</td>
</tr>
<tr>
<td>2 Critical thinking and problem solving</td>
<td>Apply some of the general principles of asset pricing for evaluation of contingent contracts.</td>
<td>Assignments (AOL)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Midsession exam</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Final exam (AOL)</td>
</tr>
</tbody>
</table>
3 LEARNING AND TEACHING ACTIVITIES

3.1 Approach to Learning and Teaching in the Course

The philosophy underpinning this course and its Teaching and Learning Strategies are based on “Guidelines on Learning that Inform Teaching at UNSW. These guidelines may be viewed at: www.guidelinesonlearning.unsw.edu.au. Specifically, the lectures, tutorials and assessment have been designed to appropriately challenge students and support the achievement of the desired learning outcomes. A climate of inquiry and dialogue is encouraged between students and teachers and among students (in and out of class). The lecturers and tutors aim to provide meaningful and timely feedback to students to improve learning outcome.

3.2 Learning Activities and Teaching Strategies

The examinable content of the course is defined by the material covered in lectures, tutorials and problem sets.

Lectures
The purpose of lectures is to provide a logical structure for the topics that make up the course, to emphasise the important concepts and methods of each topic, and to provide relevant examples to which the concepts and methods are applied. As not all topics will be presented extensively, students should refer to the textbook for further details and be sure to attempt the tutorial exercises.

Tutorials

<table>
<thead>
<tr>
<th></th>
<th>Apply the principles that lead to the efficient formation of portfolios of stocks.</th>
</tr>
</thead>
<tbody>
<tr>
<td>3a</td>
<td>Written communication</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>3b</td>
<td>Oral communication</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Teamwork</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>5a</td>
<td>Ethical, environmental and sustainability considerations</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>5b</td>
<td>Social and cultural awareness</td>
</tr>
</tbody>
</table>

The course assessments indicated with (AOL) are used to assess the Program Learning Goals and Outcomes according to the Assurance of Learning (AOL) processes of the UNSW Business School. At least some components of the AOL assessments will be marked according to the AOL rubric for the assessment criteria. The AOL rubric relevant for your course will be posted on the course Moodle site.
The object of the tutorials is to discuss various approaches to, and issues associated with the assigned exercises and topics covered in the course. Tutorial will also be used to administer short tests throughout the session. These tests will contribute to monitoring student progress as well as provide students with feedback on their learning.

Out-of-Class Study
While students may have preferred individual learning strategies, it is important to note that most learning will be achieved outside of class time. Lectures can only provide a structure to assist your study, and tutorial time is limited.

An “ideal” strategy (on which the provision of the course materials is based) might include:

- Reading of the relevant chapter(s) of the text and any readings before the lecture. This will give you a general idea of the topic area.
- Attendance at lectures. Here the context of the topic in the course and the important elements of the topic are identified. The relevance of the topic should be explained.
- Attending tutorials and attempting the tutorial questions.
4 ASSESSMENT

4.1 Formal Requirements
In order to pass this course, you must:
- achieve a composite mark of at least 50 out of a maximum of 100; and
- make a satisfactory attempt at ALL assessment tasks (see below).

4.2 Assessment Details

<table>
<thead>
<tr>
<th>Assessment Task</th>
<th>Weighting</th>
<th>Length</th>
<th>Due Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assignments (2)</td>
<td>10%</td>
<td>Section 4.4</td>
<td>See section 4.4</td>
</tr>
<tr>
<td>Midsession Exam</td>
<td>25%</td>
<td>60 minutes</td>
<td>Week 8</td>
</tr>
<tr>
<td>Final Exam</td>
<td>65%</td>
<td>120 minutes</td>
<td>University Exam Period</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4.3 Midsession Exam
A mid-session exam will be held during the lecture of WEEK 8, on Thursday, 28 April 2016. It will be of one hour in duration and will relate to the topics covered during the first six weeks of lectures.

There will be no supplementary tests offered for the mid-session exam. You should make every effort to take the mid-session exam. For students who do not attend the midsession exam, or those students who receive a higher mark for the final exam than the midsession, the final exam will have a weight of 90%.

4.4 Tutorial Assignment Submission Procedure
There will be 2 assignments each worth 5%. During the session, you will be asked to submit your answers to the assigned exercises. You will be given: i) at least one week’s notice before the assignments are handed out; ii) two weeks to complete and hand-in your assignments. The hard copy is to be submitted to an Assignment Box (to be announced), located on the ground floor of the Business School Building. Do not use plastic sheets or binders. Simply staple the pages together. Your name and ID should be on the cover page.

4.5 Late Submission
Late submissions will not be marked. ‘Special consideration’ does not apply to late submission of assignments. As each assignment is worth less than 20%, special consideration does not apply.
4.6 Quality Assurance

The Business School is actively monitoring student learning and quality of the student experience in all its programs. A random selection of completed assessment tasks may be used for quality assurance, such as to determine the extent to which program learning goals are being achieved. The information is required for accreditation purposes, and aggregated findings will be used to inform changes aimed at improving the quality of Business School programs. All material used for such processes will be treated as confidential and will not be related to course grades.

5 COURSE RESOURCES

The website for this course is on UNSW Moodle at: http://moodle.telt.unsw.edu.au

The prescribed text for the course is:

- William F. Sharpe, “Macro-Investment Analysis”, Stanford University, manuscript.

This book has not yet been published in a hard copy. It can be downloaded free of charge from William Sharpe’s website at: http://www.stanford.edu/~wfsharpe/mia/mia.htm

And some chapters from the following textbook will also be used.


Other required readings include:

- Sigmon, Kermit (1992) “MATLAB Primer”, Second Edition, Department of Mathematics, University of Florida. (This is the reference for a crash course on programming using MATLAB. The manuscript will be available for download from the course website)

Suggested additional readings include:


Additional materials such as solutions to the tutorial exercises, MATLAB codes, MATLAB tutorials etc. will be provided on UNSW Moodle.

The software for the course is MATLAB. This software is installed in the Quad Labs.

6 COURSE EVALUATION AND DEVELOPMENT

Each year feedback is sought from students and other stakeholders about the courses offered in the School and continual improvements are made based on this feedback. UNSW’s Course and Teaching Evaluation and Improvement (CATEI) Process is one of the ways in which student evaluative feedback is gathered. You are strongly encouraged to take part in the feedback process.
7 COURSE SCHEDULE

7.1 Lecture Schedule
Lectures start in Week 1 and finish in Week 12.
Tutorials start in Week 2 and finish in Week 13.

<table>
<thead>
<tr>
<th>Week</th>
<th>Topic</th>
<th>Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Week 1 starting 29 February</td>
<td>Matrices and programming; Matrix Operations; Asset Allocation; Prices I; Time-State Claims</td>
<td>Sharpe text, Ch. 2 and 3</td>
</tr>
<tr>
<td>Week 2 7 March</td>
<td>Prices II: Valuation; Multiple Commodities, States and Times</td>
<td>Sharpe text, Ch. 3</td>
</tr>
<tr>
<td>Week 3 14 March</td>
<td>Prices III: Valuation; Multiple Commodities, States and Times (contd.)</td>
<td>Sharpe text, Ch. 3</td>
</tr>
<tr>
<td>Week 4 21 March</td>
<td>Prices IV: Multiple commodities, states and times (contd.); Interest rate &amp; bond yields; Forward prices</td>
<td>Sharpe text, Ch. 3</td>
</tr>
</tbody>
</table>

Mid-semester break: Friday 25 March – Saturday 2 April inclusive

<table>
<thead>
<tr>
<th>Week</th>
<th>Topic</th>
<th>Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Week 5 4 April</td>
<td>Probabilities I Topics: Production, Consumption and Market Clearing; Binomial Option Pricing;</td>
<td>Sharpe text, Ch. 4;</td>
</tr>
<tr>
<td>Week 6 11 April</td>
<td>Probabilities II Topics: Production, Consumption and Market Clearing (contd.)</td>
<td>Sharpe text, Ch. 4</td>
</tr>
<tr>
<td>Week 7 18 April</td>
<td>Probabilities III Topics: Risk Premia; Consumption and Investment Choices</td>
<td>Sharpe text, Ch. 4; Lecture Notes</td>
</tr>
<tr>
<td>Week 8 25 April</td>
<td>Midsession Exam</td>
<td></td>
</tr>
<tr>
<td>Week 9 2 May</td>
<td>Arrow-Debreu Pricing Topics: Competitive Equilibrium, Pareto Optimality and Risk Sharing</td>
<td>Danthine and Donaldson, Ch. 9</td>
</tr>
<tr>
<td>Week 10 9 May</td>
<td>Arrow-Debreu Pricing II Topics: Implementing Allocations, Risk Neutral Valuations</td>
<td>Sharpe text, Ch. 5</td>
</tr>
<tr>
<td>Week 11 16 May</td>
<td>Risk and Return III Topics: Portfolio Choice; Portfolio Characteristics. Two-asset Portfolios</td>
<td>Sharpe text, Ch. 5</td>
</tr>
<tr>
<td>Week 12 23 May</td>
<td>Risk and Return (cont’d) + Review and extensions</td>
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</tr>
<tr>
<td>Week 13 30 May</td>
<td>NO LECTURES</td>
<td></td>
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</table>