



Foundations of Finance (B01.2311)
Spring 2007

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SYLLABUS

Texts

(BKM) Bodie, Kane and Marcus, *Essentials of Investments*, 6th edition, Irwin, 2007.
(RWJ) Ross, Westerfield and Jordan, *Fundamentals of Corporate Finance*, *CUSTOM VERSION (includes chapters 4,5 and 8)*.
(G) Garbade, *Securities Markets*, *CUSTOM VERSION*
(H) Handout Packet (Note: BRING THIS TO EVERY CLASS).

Prerequisites

This is a core course that assumes no prior background in finance. However, you are expected to have an understanding of basic economic and statistical concepts beforehand. From economics you should understand supply and demand curves, including how shifts in the curves change the equilibrium price. You will also need indifference curves from the core economics class. From statistics you should understand mean, standard deviation, covariance and correlation as descriptive statistics. The course website contains a statistics primer that covers this material. By the third week of class you will need probability statements based on the area under the normal curve. By the fourth week of class you will need the regression coefficient as a summary statistic. This material was covered in your statistics core class but it is also summarized in the statistics primer.

Before and After Book

This pamphlet, distributed on the first day of class, provides an outline of sub-topics covered in each lecture as well as a list of concept questions that relate to each topic. Use the pamphlet *before* reading the assigned material to set the stage and *after* to check your comprehension.

Emails

Check your email regularly for weekly outlines from me and other announcements

Calendar

Check the course calendar in the Handout Packet or in the course website for scheduled alterations in regular class meetings. In addition, the calendar lists dates for the mid term, final, and other deliverables.

TA Review Sessions

Thursday, 4:30-5:50, Room 2-70, KMC

Web References

The course web site can be found under *courses* at www.stern.nyu.edu/~wsilber.
A small group of websites appears in the outline to reference either real time data or educational tools that are especially relevant for a particular topic. Although the directions to the material are currently accurate they may change. You may need a few extra clicks to get to the right spot.

Location Guide

Video Tapes: Available on my web site within two days of each lecture.
Solutions Manual for BKM is on reserve at Bobst's Reserve Room.
My Office is room 965 in KMC.
TA Office is on the 7th floor in KMC

Grades and Exams

The distribution of grades, as mandated by the finance department is as follows: A, A- : Between 20 and 25 percent of the class; C+ and lower: Between 10 and 15 percent of the class; B+, B, B-: the remainder.

Grades will be based on a mid-term exam (42.5%), a final exam (42.5%) and problem sets (15%). The "Market Tracking Assignment" (see the next item in the Handout Packet) will form the basis of about 10% of the questions on each exam. Also see the discussion under **Classroom Responsibilities** below.

The mid-term and final are *not* cumulative. You must take them both. You must be present at the mid-term and final exam dates. *There will be no make-up exams during the semester.* If you miss any exam you will have to wait until the beginning of the next semester for a make-up.

Problem Sets

A pamphlet with Problem Sets for the entire term will be distributed on the first day of class. The problems are designed to provide numerical drill to complement the conceptual class discussions and are **NOT supposed to be representative of exam questions**. You must submit *handwritten answers* (no word processors or photocopies) to each set (I-IV), and to the Real Time Exercise, when they are due, as indicated in the course outline below. *Late submissions will not be accepted.* You will receive full credit (3% per set) if you have made a good faith effort to answer the questions, whether or not the answers are correct. Partial credit will *not* be awarded.

Calculator

You will need a calculator that has net present value, internal rate of return, yield to maturity, natural logarithm and exponential functions. An HP12C is sufficient for this class. You are expected to learn how to use a calculator on your own. You will need it for homework and the exam (no laptops permitted at exams).

Group Study

You are strongly advised to set up study groups to review the course material each week. You may also do your homework problems together. A minimum of three people is recommended for each study group. Try to include *at least* one non-finance major in your study group. This will broaden your group's perspective. Do not wait until exam time to set up your study group. By then it is too late.

Honor Code

You are responsible for maintaining Stern's honor code which mandates zero tolerance for cheating. Violations of the honor code will be prosecuted with a minimum penalty of failure for the course as required by honor code rules. As indicated above, you may work in groups on your homework problems but you must submit your own handwritten answers. The exams are closed book. You may bring to the exams only a writing implement and your calculator. In the event that your calculator is programmable you may NOT enter any formulae or data (e.g., associated with the market tracking assignment). If you become aware of any violations of the honor code you must take whatever steps are necessary to stop the violators.

Classroom Responsibilities and Civility

Approach each class as though you were attending an important business meeting – prepare, arrive on time, participate, but do not try to dominate. Arrange your affairs so that you do not leave the room during class (if you have a medical problem see me at the start of the semester).

Here are some specific guidelines designed to promote a beneficial classroom experience:

Class Participation: Students learn from questions asked by other students as well as by answers from classmates, whether or not the proposed answers are correct. Therefore, you have a responsibility to come to class and participate in the discussions. I will encourage class participation to the best of my ability, turning to forced compliance only after friendly persuasion fails.

No Late Seating: Each lecture begins **exactly** on time. Latecomers disrupt the class no matter how quietly they enter. Therefore, once the lecture begins please do not try to enter the class. You will not be admitted. Watch the class on video if you cannot make it on time. Absence from class should not be a routine practice, however. Classroom participation is an important responsibility.

Cell Phone Disturbances: Turn off your cell phone, palm pilot or any other type of 'audible alert device' before entering class. You will be fined \$25 (towards a year end lunch party) if any of these items go off during class time. Try not to provide financial support for our end-of-semester celebration.

Side Conversations: Do not engage in side conversations during the lecture, even in a whisper. They are distracting to me and to your fellow students and will not be tolerated.

No Laptops: Laptops are not required in this class nor are they permitted during the lecture. They are distracting to your fellow classmates. If you must use a laptop for taking notes during class see me at the beginning of the semester.

Failure to meet your classroom responsibilities may adversely affect your grade

COURSE OUTLINE

Note: A star (*) next to a Handout entry means you must prepare this item for classroom discussion

1. *Overview and Market Structure* (2 Sessions)
BKM: Chapter 3; also skim Chapters 1 and 2
H: Readings # 1*, 2, 3*
Web: Visit www.island.com, click Products, Bookviewer, Java Viewer, enter a stock symbol, and watch it trade
2. *Present Value, Yields and Returns* (1 1/2 Sessions)
RWJ: Chapter 4, 5.
BKM: Section 1 in Chapter 5 (except p.129 bottom) and Section 4 in Chapter 5
H: Reading # 4*, 5*, 6*, 7*, 8
3. *Equilibrium One Period Yields* (1/2 Session)
BKM: Sections 3, 4 and 5 in Chapter 11 and Section 4 in Chapter 5 (again)
4. *Arbitrage and the Law of One Price* (1 1/2 Sessions)
BKM: Section 2 in Chapter 18 (exchange rate risk discussion)
H: Readings # 9, 10*, 11*, 12

HAND IN PROBLEM SET I

5. *Portfolio Analysis*
 - a. *Two Risky Securities* (2 1/2 Sessions)
G: pp. 111-116, 122-131, 131-137, 145-155
BKM: Chapter 5 (Sec. 2, 3), Chapter 6 (Sec. 1, 2)
H: Readings # 13, 14*, 15*, 16*, 17*, 18*
 - b. *Risk Free and Multiple Risky Securities* (2 Sessions)
G: pp. 160-164, 165-174
BKM: Chapter 5 (Sec. 5), Chapter 6 (Sec. 3, 4, 5)
H: Readings # 19*, 20, 21*, 22*
Email: Open Portfolio Optimizer Program and experiment with it
6. *Capital Market Equilibrium* (2 Sessions)
G: pp. 179-189, 199-210, 174-176, 213-219
BKM: Chapter 7 (Sec. 1,2,3,4), Chapter 17 (Sec. 1)
H: Reading # 23*, 24

HAND IN PROBLEM SET II (make a copy for yourself)

MID-TERM EXAM (1 Session)

7. *Introduction to Capital Budgeting* (1 Session)
RWJ: Chapter 8
H: Reading # 26*
8. *Common Stock Valuation* (1 1/2 Sessions)
BKM: pp. 388-398, 403-407, 412-415
H: Readings # 27*, 28
Web: Visit www.yahoo.com, click on finance, enter a stock symbol, look at 'profile' to view company characteristics

COLLECT DATA ON REAL TIME EXERCISE

SUBMIT MARKET TRACKING CONTEST

9. *Fixed Income Securities*
 - a. *Yield Calculations* (1 1/2 Sessions)
BKM: Chapter 9 (Sec. 2, 3, 4, and pp. 277-280) and Chapter 2 (Sec. 1)
H: Readings # 29*, 30*, 31*, 32, 33

HAND IN REAL TIME EXERCISE

- b. *Yield Curve and Forward Rates* (2 Sessions)
BKM: Chapter 9 (Sec. 6)
H: Readings # 34*, 35, 36*, 37*, 38*, 39
- c. *Duration* (1 Session)
BKM: Chapter 10 (Sec. 1, 2, 3)
H: Readings # 40*, 41, 42*
- d. *Swaps* (1 Session)
BKM: pp. 562-564
H: Readings # 43*, 44, 45*
- e. *Risk and Tax Structure* [**Required Reading Assignment**]
BKM: Chapter 9 (Sec. 1, 5), Chapter 2 (Sec. 2)

HAND IN PROBLEM SET III

10. *Options* (3 1/2 Sessions)
BKM: Chapters 14 (except pp.476-478), 15 (except Sec. 2)
H: Readings # 46*, 47, 48*, 49*, 50*, 51*, 52
11. *Efficiency* (1 Session)
BKM: Chapter 8
H: Readings # 53

HAND IN PROBLEM SET IV (Make a copy for yourself)

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FOR YOUR READING PLEASURE

Peter Bernstein's *Capital Ideas* (Wiley, 2005) provides a wonderful overview of how the great ideas of finance arose. His book is the best way to appreciate the financial revolution of the past half century. Burton Malkiel's *A Random Walk Down Wall Street* (Norton 2003) is the only investment guide you will ever need. He sells nothing but sound advice. Roger Lowenstein's *When Genius Failed* (Random House, 2000) is a best seller about the best and the brightest in finance. Read it for the cautionary message. My book, *When Washington Shut Down Wall Street* (Princeton University Press, 2007) tells the story of how America's triumph over the financial crisis of 1914 launched the U.S. as a world financial power. Read it for perspective and for a compelling tale demonstrating the law of unintended consequences.