

International Financial Markets, FNCE 219/719
University of Pennsylvania
The Wharton School

Fall Term 2008
Professor Urban J. Jermann

Office hours: Wednesday 1:00 to 3:00 pm, SH/DH 2327
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the class webpage)
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Prerequisites For 219: FNCE 100, FNCE 101 or ECON 4, STAT 101
For 719: FNCE 601 + 602 (FNCE 602 can be taken concurrently)

Reading Materials

A customized book with readings has been prepared for this class by McGraw-Hill Primis, ISBN: 0-390-73199-4, it is available at the bookstore.

A bulkpack containing a first set of lecture notes, homework questions and additional readings is available from reprographics.

Additional lecture notes, readings, assignments, homework questions and answers and other material will be handed out in class. There will a bursar-billed fee for course handouts estimated to be less than \$40. Most of the course material will also be made available on my website.

Students are encouraged to read publications such as the Financial Times, the Wall Street Journal, the Economist and Euromoney.

Course Requirements

- **Two Examinations** are scheduled for

Tuesday, **October 7**, in class

Tuesday, **November 25**, in class (just before Thanksgiving break)

Each exam will count for 35% of the final grade. Unexcused absences from exams will result in a zero score in the calculation of the final grade. Excused absences from exams require approval prior to the exam. Exams are closed book, but you may prepare a letter sized sheet (8.5 by 11) with your notes.

- **Five Written Assignments** will count together for 25% of the final grade; the lowest assignment score will be dropped. Each student is expected to join a project group consisting of 3-5 members. The project groups will jointly prepare and submit written assignments. The individuals constituting a group must remain the same over the semester, so please choose your groups carefully. To help reduce problems due to free-riding etc., group members will be asked near the end of the term to evaluate the participation of the other group members. This

confidential evaluation may affect the individual grade obtained for the assignments.

Assignments will be distributed in class about a week before they are due, and will then be available on the class webpage. **LATE ASSIGNMENTS WILL NOT BE ACCEPTED.** The written assignments will be discussed in class and answers will not be distributed.

- **One Short Quiz** of about 15 minutes will take place during the last class, on Thursday December 4. This quiz will count for 5% of your final grade and will cover material from the preceding lecture

Regrading exams and graded assignments

Any request for regrading must be submitted in writing within two weeks from the date the exams or assignments have been returned. The exam or assignment should be placed in my mailbox in the Finance Department.

The request for regrading must be very specific. When you request a regrade, the entire exam or assignment may be regraded. Unambiguous errors in grading will be promptly corrected. In order to avoid possible attempts to alter exams before a regrade is requested, a substantial fraction of the exams will be photocopied.

Homework

Several problem sets will be assigned during the semester and you will be given the answers to these. The purpose of these exercises is to give you the opportunity to make sure you fully understand topics covered in class. By regularly doing these exercises you get excellent training for exams and assignments and you will maximize your return from this class. These problem sets will not be graded, and you should feel free to work in groups.

Course Outline

This class is about the international financial markets and their financial instruments. The central themes are currency exchange rates, related derivative securities and international asset allocation. The class will adopt the perspective of international investors as well as the perspective of internationally active firms.

Each of the following numbered topics covers approximately one week of classes.

FX basics

1. Introduction: Derivative usage, exchange rates since 1971
2. Spot Foreign Exchange Markets
Manipulating exchange rates, FX market structure, arbitrage
3. Eurocurrency Markets, Forward Contracts and Interest Rate Parity
4. Forward Contracts: Valuation and Hedging

FX derivatives

5. Currency Futures: Futures markets, hedging and speculating with futures
6. Currency Options
Put-call parity, hedging with options, option pricing issues, Black-Scholes model
7. Currency and Interest Rate Swaps
Examples and motivations for swaps, swap valuation
8. Specialized FX derivatives: US Dollar Index contract, quantos

International asset allocation / Exchange rate theories

9. Exchange Rate Theories and Evidence: Purchasing Power Parity, Balance of Payments
10. International Equity Portfolios: International diversification, hedging fx risk
11. Expectations, Forward Rates and Interest Rates
Uncovered interest parity, carry trades, risk reversal
12. Quantifying Exchange Rate Risk

Several current event topics are treated at various points in the semester.

Classes, Assignments and Exams

Thu, Sept 4

Tue, Sept 9

Thu, Sept 11

Tue, Sept 16

Thu, Sept 18

Tue, Sept 23

Thu, Sept 25 Assignment #1 discussed, project groups are fixed

Tue, Sept 30

Thu, Oct 2

Tue, Oct 7 Exam 1— in class

Thu, Oct 9 Assignment #2 discussed

Tue, Oct 14 No Class: Fall Break

Thu, Oct 16

Tue, Oct 21

Thu, Oct 23

Tue, Oct 28

Thu, Oct 30 Assignment #3 discussed

Tue, Nov 4

Thu, Nov 6

Tue, Nov 11

Thu, Nov 13 Assignment #4 discussed

Tue, Nov 18

Thu, Nov 20

Tue, Nov 25 Exam 2 — in class

Thu, Nov 27 No Class: Thanksgiving

Tue, Dec 2

Thu, Dec 4 Short Quiz — in class // Assignment #5 discussed