



Boston University Study Abroad London

Boston University Study Abroad London European Capital Markets CAS EC 346 (*Elective A*), Spring 2016

Instructor Information

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Course Objectives

This course is designed to introduce students to Global financial markets with an emphasis on the European dimension. Students will learn about various international financial markets such as the foreign exchange market, the Eurocurrency market and Eurobond market. In addition, students will study a range of financial instruments such as bills and bonds, collateralised debt obligations and credit default swaps, options, forwards and futures. The course will also mention topical issues such as European Monetary Union and International Financial Crisis.

Reading

The **main text** to be used on this course are:

Keith Pilbeam (2010), Finance and Financial Markets (F&FM), Palgrave Macmillan.

Additional readings may be posted on the course webpage: <http://learn.bu.edu>

Course Requirements

STUDENTS WHO ARE ON THE COURSE MUST BRING WITH THEM TO EVERY SESSION THE FOLLOWING:

1. A calculator - **NOT on mobile/cell phone!**
2. A copy of that day's Financial Times (supplied by Boston University).
3. Students will also benefit from reading the Economist magazine (weekly).

Assessment

The assessment on this course is made up of three factors (weighting in brackets):

- 1) Attendance plus Internet Project report. (15%)
- 2) In class test 1 hour Monday 8th February (35%)
- 3) Final exam Tuesday 16th February - of 2 hours, 50 question MCQ paper answer test 2 marks each. The test covers the whole of the course with slightly more emphasis placed on the second part of the course. (50%)

Grading Scale

The following scale will be applied:

A = 90+, A- = 85-89, B+ = 80-84, B = 75-79, B- = 70-74,
C+ = 65-69, C=60-64, C-=55-59, D = 50-54, F less than 50.

Grading

Please refer to the Academic Handbook for detailed grading criteria and policies on plagiarism:

<http://www.bu.edu/london/current-semester>

** Final Grades are subject to deductions by the Academic Affairs Office due to unauthorised absences.*

Attendance Policy

Classes

All Boston University Study Abroad London Programme students are expected to attend each and every class session, tutorial, and field trip in order to fulfill the required course contact hours and receive course credit. Any student that has been absent from two class sessions (whether authorised or unauthorised) will need to meet with the Directors to discuss their continued participation on the programme.

Authorised Absence:

Students who expect to be absent from any class should notify a member of Academic Affairs and complete an Authorized Absence Approval Form 10 working days in advance of the class date (except in the case of absence due to illness, for which students should submit the Authorised Absence Approval Form with the required doctor's note as soon as possible). **Please note: Submitting an Authorised Absence Approval Form does not guarantee an authorised absence**

Students may apply for an authorised absence only under the following circumstances:

- Illness, supported by a local London doctor's note (submitted with Authorised Absence Approval Form).
- Important placement event that clashes with a class (verified by internship supervisor)
- Special circumstances which have been approved by the Directors (see note below).

The Directors will only in the most extreme cases allow students to leave the programme early or for a significant break.

Unauthorised Absence:

Any student to miss a class due to an unauthorised absence will receive a **4% grade penalty** to their final grade for the course whose class was missed. This grade penalty will be applied by the Academic Affairs office to the final grade at the end of the course. As stated above, any student that has missed two classes will need to meet with the Directors to discuss their participation on the programme as excessive absences may result in a 'Fail' in the class and therefore expulsion from the programme.

Lateness

Students arriving more than 15 minutes after the posted class start time will be marked as late. Any student with irregular class attendance (more than two late arrivals to class) will be required to meet with the Assistant Director of Academic Affairs and if the lateness continues, may have his/her final grade penalised.

Course Timings

Wednesday 13th January

Monday 18th January

Tuesday 19th January

Monday 25th January

Tuesday 26th January

Monday 1st February

Tuesday 2nd February

Monday 8th February (in class Test)

Tuesday 9th February

Tuesday 16th February (Final Exam)

*** Contingency Class Date: Friday 5th February** Students are obligated to keep this date free to attend classes should any class dates need to be rescheduled.

INTERNET PROJECT - by Tuesday 9th February TO THE PROFESSOR, STUDENTS MUST HAND IN THEIR INTERNET PROJECT. I EXPECT YOU TO REVIEW 5 FINANCE SITES ON THE WEB TELLING ME WHAT YOU LIKE ABOUT THE SITES AND DISLIKE ABOUT THEM. APPROXIMATELY 150 WORDS PER SITE.

Bank of England Trip Friday 5 February

Bank of England visit (combination of guided walking tour and museum visit)

A detailed email will be sent to students outlining the groups and directions.

Final Exam: Tuesday 16th February Students MUST bring a calculator to the final exam. Calculators on mobile/cell phones are not permitted!

Exam times and locations will be posted on the BU London website and in the Student Newsletter two weeks before exam dates.

SESSION 1: INTRODUCTION TO THE FOREIGN EXCHANGE MARKET

- 1.1 Introduction
- 1.2 Exchange rate definitions
- 1.3 Characteristics and participants in the foreign exchange market
- 1.4 The Spot and Forward exchange rates
- 1.5 Hedging in the foreign exchange market
- 1.6 Arbitrage in the foreign exchange market
- 1.7 Speculation in the foreign exchange market
- 1.8 Nominal, real and effective exchange rates
- 1.9 Conclusions

SESSION 2: FORWARD EXCHANGE RATES AND COVERED INTEREST PARITY

- 2.1 A simple model of the determination of the spot exchange rate
- 2.2 The difference between sterilized and non sterilized foreign exchange intervention
- 2.3 Covered interest parity (CIP) and the determination of the forward exchange rate
- 2.4 Conclusions

Main Reading Sessions 1 and 2:

Pilbeam (F&FM) chapter 11

SESSION 3: PURCHASING POWER PARITY AND UNCOVERED INTEREST PARITY

- 3.1 Introduction
- 3.2 Purchasing Power Parity (PPP) theory and the law of one price
- 3.3 Absolute and relative PPP
- 3.4 Empirical evidence on PPP
- 3.5 Summary of empirical evidence on PPP
- 3.6 Explaining the poor performance of Purchasing Power Parity Theory
- 3.7 Uncovered Interest Parity (UIP)
- 3.8 The economics of the carry trade
- 3.9 Conclusions

Main Reading:

Pilbeam (F&FM) chapter 12 pp.289-299

SESSION 4: MONEY MARKET OPERATIONS & INTERNATIONAL MONEY MARKET

- 4.1 Difference between bills and bonds
- 4.2 Expansionary and contractionary open market operations in theory and practice
- 4.3 The term structure of interest rates and the yield curve
- 4.4 Theories of the yield curve
- 4.5 The origins and development of the eurodollar market
- 4.6 The characteristics of the eurodollar market
- 4.7 The creation of eurodollar deposits and Eurodollar loans
- 4.8 The TED spread
- 4.9 Euromarkets and currency and country risks
- 4.10 Euromarkets and Government Regulation and Policy and LIBOR scandal
- 4.11 Conclusions

Main Reading:

Pilbeam (F&FM) chapter 4 pages 71-78 & 87-93, chapter 5

SESSION 5: THE INTERNATIONAL BOND MARKET, COLLATERALIZED DEBT OBLIGATIONS AND CREDIT DEFAULT SWAPS

- 5.1 Domestic bonds, Eurobonds and Foreign bonds
- 5.2 Structure of the market
- 5.3 A Eurobond issue
- 5.4 The role of the Credit Rating Agencies (CRAs)
- 5.5 Features of a typical Eurobond
- 5.6 Regulation and taxation
- 5.7 The role of the lead manager, underwriters and selling group
- 5.8 Collateralized Debt Obligations (CDOs)
- 5.9 Credit Default Swaps (CDSs)
- 5.10 Conclusions

Main Reading:

Pilbeam (F&FM) chapter 6 and chapter 17 pages 411-429

SESSION 6: FUTURES MARKETS

- 6.1 Futures contracts the basics
- 6.2 Stock index futures the S&P500 contract
- 6.3 Hedging, speculation and arbitrage
- 6.4 Reversing trades and open interest
- 6.5 Pricing of S&P500 stock index futures
- 6.6 Interest rate futures
- 6.7 Conclusions

Main Reading:

Pilbeam (F&FM) chapter 13

SESSION 7 OPTIONS THE BASICS

- 7.1 Basic terminology
- 7.2 Call and Put option examples
- 7.3 The margining process
- 7.4 European and American Options
- 7.5 Options on individual stocks
- 7.6 The straddle payoff
- 7.7 Conclusions

Main Reading:

Pilbeam (F&FM) chapter 14

SESSIONS 8 & 9 OPTIONS MORE ADVANCED ISSUES

- 8.1 The intuition behind option pricing.
- 8.2 Option Trading Strategies Straddles and Strangles
- 8.3 Intrinsic value and time value
- 8.4 In the money and out of the money options
- 8.5 The behaviour of time value as the share price changes
- 8.6 Determinants of call option premium
- 8.7 The VIX index.
- 8.8 Conclusions

Main Reading:

Pilbeam (F&FM) chapter 15 pages 373-379 and for VIX index pages 384-5