

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

Fall Term 2004
Professor Urban J. Jermann

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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: 0-390-50139-5, 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 be 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 Financial Times, Wall Street Journal, and Euromoney.

Course Requirements

! **Two Mid-term Examinations** are scheduled for

Thursday, **October 21** C in class

Thursday, **December 9** C in class

Each mid-term exam will count for 40% 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 formal excuses by the Academic Services Office. Exams are closed book, but you may prepare a letter sized sheet (8.5(11) with your notes.

! **Five Written Assignments** will count together for 20% 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 two or more lectures before they are due. Students missing class may pick them up from the “pick-up boxes” in the Finance Department, Steinberg-Dietrich Hall Room 2300, in the reception area. **LATE ASSIGNMENTS WILL NOT BE ACCEPTED.** The written assignments will be discussed in class and answers will not be distributed. After grading, written assignments will be available in the pick up boxes in the Finance Department.

Regrading exams and graded assignments

Any request for regrading must be submitted in writing within two weeks from the date the exams or assignments are available for pick-up. The exam or assignment should be placed in my mailbox in the Finance Department. I will then transmit it to the TA responsible for grading.

The request for regrading must be very specific. When you request a regrade, the TA retains the right to regrade the entire exam or assignment. Unambiguous errors in grading will be promptly corrected.

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: International Financial Markets

Derivative usage, international monetary system

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

International asset allocation / Exchange rate theories

8. Exchange Rate Theories: Purchasing Power Parity, Balance of Payments

9. International Equity Portfolios

Equity markets, international diversification

10. Expectations, Forward Rates and Interest Rates

Unbiased expectations hypothesis, carry trade, risk reversal

11. Quantifying Exchange Rate Risk

Several current event topics, e.g. currency crises, are treated at various points in the semester.

Classes, Assignments Due and Exams

Thu, Sept 9

Tue, Sept 14

Thu, Sept 16

Tue, Sept 21

Thu, Sept 23

Tue, Sept 28

Assignment #1 due, project groups are fixed

Thu, Sept 30

Tue, Oct 5

Thu, Oct 7

Tue, Oct 12

Assignment #2 due

Thu, Oct 14

Tue, Oct 19

Thu, Oct 21

Mid-term exam 1

Tue, Oct 26

No Class: Fall Break

Thu, Oct 28

Assignment #3 due

Tue, Nov 2

Thu, Nov 4

Tue, Nov 9

Thu, Nov 11

Assignment #4 due

Tue, Nov 16

Thu, Nov 18

Tue, Nov 23

Assignment #5 due

Thu, Nov 25

No Class: Thanksgiving

Tue, Nov 30

Thu, Dec 2

Tue, Dec 7

Thu, Dec 9

Mid-term exam 2