

## Financial Economics

Year 2008 will undoubtedly go into history books as the time of global financial crisis. Stock markets across the world plummeted down in a way not seen since the Great Depression. Governments and central banks across the world engaged in unprecedented wave of bailouts of troubled financial institutions. Most of the industrialized countries went into recession. The crisis had its roots in mortgage markets, in particular, reckless lending to the so-called subprime borrowers and misjudgment of risks in trading mortgage-backed securities.

The objective of the course is to discuss some aspects of the financial crisis from the perspective of modern financial economics. The first part of the course is intended to provide students with foundations for the study of financial economics. It will be concerned with two-period models of security (or asset) markets. We will discuss basic theories of investor's behavior and competitive equilibrium in security markets. The discussion will be primarily based on the textbook. The second part of the course will focus on dynamic models of security markets. Some aspects of the current financial crisis – such as **pricing bubbles, speculative trading, market crashes, and market liquidity**– will be discussed. The discussion of these topics will be based on journal articles and working papers.

**Textbook:** *Principles of Financial Economics* by Stephen F. LeRoy and Jan Werner, Cambridge University Press, 2001.

### Course Outline:

1. Arbitrage and Valuation in Security Markets.
2. Choice under Risk and Ambiguity.
3. Equilibrium Prices and Allocations in Security Markets.
4. Mean-Variance Analysis.
5. Dynamic Security Markets: Equilibrium, Arbitrage, and Security Pricing.
6. Pricing Bubbles and Speculative Trading.
7. Market Liquidity.
8. Asymmetric Information and Market Crashes.

**Course Website:** [www.econ.umn.edu/~jwerner](http://www.econ.umn.edu/~jwerner)

**Course Readings:** A list of articles and books will be announced in class.

**Homeworks, Exams, Presentations and Grades:**

There will be problem sets and a final exam. Students are encouraged to make in-class presentations of research articles. In order to obtain credit for this course students must choose between a final examination and writing a paper. Students who decide to write a paper should discuss the topic of their paper with me as soon as possible.

**Office Hours:**

Mondays, 1:00 - 2:30 p.m., 4-139 Hanson Hall, or by appointment.

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