

UNIVERSITY OF ALABAMA

Finance 601
Finance Theory I

Spring 2015
Professor Harris Schlesinger

Office: 235 Alston Hall

Phone: 348-7858

Office Hours: 8:30 to 9:30 Wednesdays, or by appointment.

Webpage: <http://hschlesinger.people.ua.edu/fi-601-finance-theory-i.html>

Course Information

General Remarks: This is a first course in financial theory, with a particular emphasis on intertemporal portfolio choice and on the fundamentals of asset pricing, for Ph.D. students. We will examine the notion of “no arbitrage” in financial markets and compare it with equilibrium pricing. We also introduce the basics of asymmetric information and how the problems it imposes can be mitigated via contract design. The course is designed to build a foundation for future courses in finance. All models remain within the confines of discrete time throughout this course. After successfully completing this course, you should understand the economic intuition behind mathematical models of financial pricing.

Prerequisites: All students ideally should have had courses roughly equivalent to FI 510 (Financial Management), EC 610 (Microeconomic Theory), EC 570 (Math for Economists) and ST 550 (Statistical Methods). If you are unsure of your background, please check with Professor Schlesinger.

Grades: There will be two exams, each worth 40% of your total grade. Assigned homework problems will be worth another 20% of your grade.

Remark: Exams are based upon materials covered in the class notes and the homework assignments. The text material is meant as an aid to your understanding of the class lectures. Should you find it necessary to miss any of the class lectures, you should obtain that day's class notes from one of your fellow students.

Make-up exams and attendance: Every missed exam or assignment receives a grade of zero unless explicitly exempted by the professor. All requests for an exemption and/or make-up assignment must be requested in writing (e-mail is sufficient) at the earliest feasible time

Special requirements: Students with special needs or with disabilities should contact the Professor prior to any exams or assignments to make arrangements.

Homework: There will be several homework problems assigned during the semester. The answers are to be written up neatly and turned in when due. You should take the effort to be careful and complete in writing up your answers. You are encouraged to work with other students in this class in working on the homework problems; but I do require that you write up your own answers to turn in.

Text: Eeckhoudt, Gollier and Schlesinger, *Economic and Financial Decisions under Risk*, 2005, Princeton University Press. ISBN 0691122156 (paperback edition).

Alternative Texts: No textbook is considered the “standard” for a first Ph. D. course in financial theory. The ones below have been placed on reserve at the Bruno Library.

Danthine and Donaldson, *Intermediate Financial Theory*, 3E, 2015, Academic Press, ISBN 978-0-12-386549-6

Eichberger and Harper, *Financial Economics*, 1997, Oxford University Press, ISBN 0-19-877540-7

Fama and Miller, *The Theory of Finance*, 1972, Dryden, ISBN 0-03-086732-0

Huang and Litzenberger, *Foundations for Financial Economics*, 1988, North Holland, ISBN 0-444-01310-5

Ingersoll, *Theory of Financial Decision Making*, 1987, Rowman & Littlefield, ISBN 0-8476-7359-6

Course Outline

<u>TOPIC</u>	<u>TEXT</u>
<u>Part I: Uncertainty Basics</u>	
1. Risk Aversion and Prudence	EGS1, DD4, EH1, HL1
2. Stochastic Dominance	EGS2, DD4, EH1, HL2
<u>Part II: Static Choice</u>	
3. Static Portfolio Choice	EGS4, DD5&6, EH2, HL4, I3
4. Complete Markets	EGS5, EH3, DD9, HL5
5. Modigliani-Miller	DD17, EH5, HL5, I19
<u>Part III: Intertemporal Choice</u>	
6. Consumption and Savings	EGS6, DD5, FM1, HL7, I11
7. Dynamic Portfolio Management	EGS7, FM8, HL7, I11
<u>Part IV: Asset Pricing</u>	
8. Review (?) of General Equilibrium	J&R 5.1&5.2, DD1 (appendix)
9. Efficient Risk Sharing	EGS10, DD9&10, EH3, HL5, I8
10. Equilibrium Asset Pricing	EGS11, DD9&10, EH2&3, HL4
<u>Part V: Asymmetric Information</u>	
11. Adverse Selection	EGS12, EH6
12. Principal-Agent Model	EGS12