

# Financial Economics

## Economics 104



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### About your teacher ...

- **Parsons 1261**
- ***[garyrevans@gmail.com](mailto:garyrevans@gmail.com)***
- **[www2.hmc.edu/~evans/index.html](http://www2.hmc.edu/~evans/index.html)**
  - **course material here!!**
- **Office TuTh 2:45-4:00**
  - **and appointments**
- **My qualifications to teach this**



## **General Modular Structure of Econ 104**

### **Module 1 - Introduction to Equities**

.. markets, indexes, quotations

### **Module 2 - Equity Performance**

... stock selection, historical market performance, trading

### **Module 3 - Mutual Funds, ETFs, Retirement**

.. structure, portfolios, how traded, fees, 401Ks, IRAs, ESOPs, ISOPs

### **Module 4 - Equity-based Derivatives**

.. put and call options, warrants, trading strategies

## **Modular Structure (cont).**

### **Module 5 - Yield-bearing Financial Assets**

.. Treasuries, corporates, municipals, zero-coupons, yields and prices, mortgage-backed, money market ..

### **Module 6 - FOREX and Futures Contracts**

.. Commodity and futures markets, foreign exchange

### **Module 7 - Real Estate**

.. Financing, fees, connection to MBS market, strategy

### **Module 8 - Investment Strategy**

## Assignments for this module

- For links to all assignments for any module always go to the course calendar at <http://www2.hmc.edu/~evans/e104cc.html> and find the relevant link.
- For this module the link goes to <http://www2.hmc.edu/~evans/e104m1.html>
- There you will see the reading assignments for this module and
  - Assignment 1 part 1 due Jan 27
  - Assignment 1 part 2 due Feb 5 in next module.

## About the reading and homework ...

- Some reading is local or internet-based
- See the CO for two books assigned
- Buy two three-ring binders
- Become familiar with course sites
- Color copies of lecture slides are found at <http://www2.hmc.edu/~evans/e104ls.htm>
- Some homework assignments are detailed and long, are not collected or graded, but important for the exams (not to mention learning something).
- **Organization, organization, organization!!!**

## Course Objectives

- Personal financial preparation
- Professional preparation
- Extensive overview of finance markets
- To encourage entrepreneurship
  - and to discuss means of finance
- A means of reviewing theory
  - although not substantial theory content in this course ... that's in Econ 136.

## Investment Objectives

- Intermediate and long-term targets
  - Low double-digit is realistic
  - I do talk a lot about short term trading in this class, but the emphasis is in intermediate and long-term goals.
- Adjusted by attitude about risk
  - Avoid catastrophic loss
- Consider tax consequences
- Diversification
  - Mix equities and YBFAs

## Major Securities Markets

- **Equities (stocks)**
  - New York Stock Exchange (NYSE), NASDAQ, American Stock Exchange (ASE), regional exchanges, Electronic Clearing Networks (ECNs), global EXs
- **Yield-bearing Bills, Notes and Bonds (YBFAs)**
  - U.S. Treasuries, Corporates, Municipals, exotics
  - Money Market Financial Assets (MMFA)
- **Real Estate**
- **Derivatives**
  - Options and Futures
- **Foreign Exchange (FOREX) markets**

## The essential features and differences

- **Equities (stocks)**
  - The buyer will legally own a very small percentage of a publicly-traded corporation
  - Performance is determined by rises (capital gains) and declines (capital losses) in the price of the stock.
  - 75% of S&P500 stocks pay dividends, average 1.8% yield. Most smaller companies pay no dividends.
- **YBFAs**
  - These are debt instruments. You are legally making a loan to the issuer and are promised an interest yield in return.
  - You may also suffer modest capital gains or losses with YBFAs.

## The essential features (cont)

- **Derivatives**

- A financial asset that is contractually linked to an underlying primary financial asset or commodity.
- Examples: An call option on AMD that is linked to AMD stock or a Crude Oil futures contract that is linked to the price of crude oil
- Performance is determined by gains and losses in the price of the derivative.

- **Real Estate**

- From a strictly financial perspective, performance is determined by gains or losses in the price of the real estate owned.

## Composite Diversified Investments

- **Mutual funds**

- Hugely popular diversified investment funds that pool investors money to purchase large quantities of many stocks (equity funds), many YBFAs (yield-bearing funds), or both (mixed funds).

- **Hedge funds**

- Similar to mutual funds, but investments are restricted by income and wealth requirements.
- Sometimes have very narrow and often risky investment objectives.
- Unlike mutual funds, often make heavy use of derivatives.
- Relatively unregulated.

## How much of this is accessible to you?

By opening a brokerage account (online recommended), nearly every financial asset discussed in this class is accessible to you, typically easily, conveniently, and at very low transactions costs (if done online).

Mutual funds can be easily accessed by opening an account at one or more of the many mutual fund families or through brokerage accounts.

YBFAs are little harder to buy and sell and fees are a little higher, but brokers will handle these as well (not always online though). U.S. Treasuries can be bought and redeemed through Treasury Direct (including online).

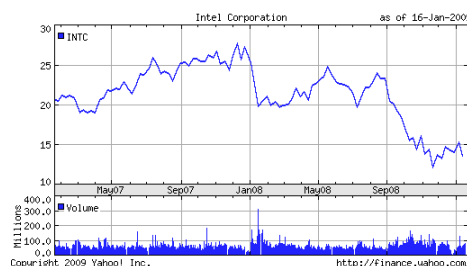
Most online brokers and mutual funds accept very small initial accounts.

## About markets today ...



You can either view this as a disaster or an opportunity. (Alas, for many who were unprepared, it can be nothing but a disaster).

For you, being so young, it is an opportunity.



Here, for example, is Intel (INTC). Today it was as low as 13.14. They pay a 5% dividend at this price. They have little debt. Where will they be in five years?