NEW YORK UNIVERSITY
Stern School of Business - Undergraduate Division

C45.0030 — Richard Levich
International Financial Management — Spring 2006

COURSE OUTLINE AND READING LIST

OVERVIEW

In this course, we explore the characteristics of international financial markets and examine some international aspects of corporate financial management. In the sections that deal with international financial markets, we address a standard set of questions including:

- What are essential institutional and organizational features of the market place?
- What are the fundamental determinants of prices and price relationships in the market?
- Are market prices set efficiently in relation to an economic model, or is there evidence of market inefficiencies or shortcomings in the theoretical models?
- What are the major policy decisions facing private individuals and corporate financial managers, as well as public policymakers and regulatory agencies in each market?

In the topics that relate primarily to financial management, our emphasis is on how a financial manager should use his/her knowledge of international financial markets to address questions such as:

- How to measure the firm's exposure to financial and operational risks
- How to manage the firm's exposure to financial and operational risks
- How to evaluate international projects and exploit differences in the cost of capital

PREREQUISITES

The Undergraduate College core courses C15.0002 (Foundations of Financial Markets) and C45.0011 (Global Business Environment) are essential prerequisites for this course.

ASSIGNMENTS AND GRADING

Students will be required to complete three in-class exams (60% of grade). Several written cases and exercises (30% of grade) will be assigned. The balance of the grade is based on class participation.

TEXT

Richard M. Levich, *International Financial Markets: Prices and Policies*, second edition, (New York: Irwin/McGraw-Hill), 2001. (RML)

Chapters from the text are noted in the outline as *RML*. Other readings will be distributed in class (C) or available on our Blackboard site via links. A set of questions is included at the end of each chapter. You should find it useful to go through these questions by yourself to test your understanding of each chapter.

Special Class Project – Foreign Currency Trading Simulation

Throughout the semester, students will participate in a foreign currency trading and portfolio management simulation on the OANDA trading platform. In the simulation, students will make use of theoretical currency pricing models and empirical findings on exchange rate behavior to formulate their foreign exchange positions, and then track their performance over the semester. More details on the foreign currency trading simulation are available in a separate handout – "Sapphire Currency Trading Partners."

HOW TO REACH ME

In Person:	Stern School of Business, 44 West 4th Street, Room 9-90, New York, NY 10012-1126.
Office Hours:	Tuesday, 2:30 pm - 4:30 pm and Wednesday, 10:00 am - 12:00 Noon and by appointment.
Electronically:	Phone: 212-998-0422; FAX: 212-995-4220; E-mail: rlevich@stern.nyu.edu [Please use only for personal messages. Use **Blackboard** for general questions and comments.]
My Secretary:	Mr. David Bosch, Tisch Hall, Room 414A, Phone: 212-998-0347; E-mail: dbosch@stern.nyu.edu
Course Web Page:	http://sternclasses.nyu.edu/ Watch this page for course announcements, due dates of assignments, chat room discussions, and other information. Please use the Blackboard "Discussion Boards" for making comments and raising questions of general interest.

IMPORTANT CLASS POLICIES

Honor Code

Consistent with Stern's honor code, your quizzes, exams, problem sets, and group reports must be solely your own work. Any attempt to represent the work of others as your own will be considered plagiarism and will be referred to the Stern discipline committee. Penalties for academic offenses such as plagiarism and cheating have ranged from probation to expulsion.

Cellular Telephone Use

Please do not use cellular telephone equipment during class. Persistent violations will impact your class participation score and your class grade.

Laptop / Notebook PC Use

You are permitted to use personal computers in class if, and only if, you are using the computer to take class notes or research materials pertaining to classroom discussion. Please let me know before class if you intend to use a PC during class so that I can record your name. Within 30 minutes of the end of class, you are the required to send me an e-mail attaching the classroom notes and materials that you worked on during class. Failure to send a confirming e-mail will impact your class participation score and may impact your future classroom PC privileges.

Attendance

This course uses learning methods that require active involvement (e.g. discussions, exercises, simulations, etc.). Thus, attendance is required for every class session. I will expect that you come to class ready to discuss the readings. Absence, lateness, and lack of preparation each have a negative impact on the class participation grade.

One-Minute Memos

As part of your class participation, you will be asked to complete a 1-minute memo at the end of every class. The purpose of the 1-minute memo is to establish a direct line of communication from you to me so that I can assess the class's grasp of the main point of the day, identify unclear points, and address other concerns. I want students to feel that they can be open and honest in these memos, and so will grade them Pass/Fail. "Pass" means simply that you handed in something that attempted to respond to my questions. "Fail" means you handed in nothing. Your grade is not affected by what you communicate to me on these memos. If you are not present, there will be no 1-minmute memo from you, and an absence will be recorded.

BRIEF SCHEDULE OF CLASSES AND TOPICS **(SUBJECT TO CHANGE)**

Week 1	Jan 17	Introduction, Currency Trading Game and OANDA	Jan 19	International Monetary System, Financial Crises (RML-2)
2	Jan 24	FX Markets: Market Structure and Institutions (RML-3)	Jan 26	FX Markets: Market Structure and Institutions (RML-3)
3	Jan 31	International Parity Conditions – PPP (RML-4)	Feb 2	International Parity Conditions – Covered and Uncovered IRP (RML-5)
4	Feb 7	Determinants of Spot Rates: Theory (RML-6)	Feb 9	Determinants of Spot Rates: Empirical Evidence (RML-6)
5	Feb 14	Quiz #1 – Chapters 1-5	Feb 16	FX Market Efficiency (RML-7)
6	Feb 21	FX Market Efficiency, part 2	Feb 23	FX Forecasting (RML-8)
7	Feb 28	Eurocurrency Markets (RML-9)	Mar 2	Eurobond Markets (RML-10)
8	Mar 7	International Bond Markets, Portfolio Diversification and Currency Overlay (RML-14)	Mar 9	International Equity Markets (RML-15)
	Mar 14	SPRING BREAK	Mar 16	SPRING BREAK
9	Mar 21	Currency Futures and Hedging (RML-11)	Mar 23	Quiz #2 – Chapters 6-10, 14
10	Mar 28	Currency and Interest Rate Options (RML-12)	Mar 30	Currency and Interest Rate Options (RML-12)
11	Apr 4	Currency and Interest Rate Swaps (RML-13)	Apr 6	Currency and Interest Rate Swaps (RML-13)
12	Apr 11	International Cost of Capital	Apr 13	International Capital Budgeting
13	Apr 18	Measuring Exposure to International Financial Risks (RML-16)	Apr 20	Measuring Exposure to International Financial Risks (RML-16)
14	Apr 25	Managing Exposure to International Financial Risks (RML-16)	Apr 27	Class Review
	May 2	No Classes – Reading Day	May 4	Final Exam, 8:00 – 9:50 a.m.

LIST OF TOPICS AND ASSIGNMENTS

Week 1 — Introduction to the Study of International Financial Markets and Recent Developments in International Financial Markets

RML, Chapters 1, 2

TOPICS: Understanding prices and price behavior in international financial markets, policy issues facing private individuals, firms, and public policymakers; Overview of international monetary arrangements in theory and in practice, recent developments in exchange rates and interest rates, currency boards, the European Monetary System transforms into the European Monetary Union.

Note: Chapter 1 is an introduction to the text and Chapter 2 reviews themes covered in your core course "Global Business Environment." Accordingly, you may skim these chapters. They will not be covered specifically in class.

Week 2 — Foreign Exchange Markets: Market Structure and Institutions

RML, Chapter 3

TOPICS: Market participants; volume, composition, growth and profitability of trading; foreign exchange products and activities, the relationship between spot and forward contracts, synthetic contracts (the replicating portfolio idea), trends toward automated trading, managing trading risks, the CLS Bank.

ASSIGNMENT: Chapter 3, Exercises 1, 2, 6, 7, 10, and 11.

Week 3 — International Parity Conditions: Purchasing Power Parity

RML, Chapter 4

TOPICS: International parity conditions in a perfect capital market, why parity conditions are useful, absolute and relative PPP, empirical evidence on PPP, concept of mean reversion, managerial and forecasting decisions and PPP.

ASSIGNMENT: Chapter 4, Exercises 3, 5, 6, and 7.

International Parity Conditions: Interest Rate Parity and the Fisher Parities

RML, Chapter 5

TOPICS: Interest rate parity and covered interest arbitrage, one-way and round trip arbitrage, the impact of transaction costs, taxes and uncertainty on parity; uncovered interest parity or the International Fisher Effect, financial strategies based on deviations from parity, the forward rate unbiased condition, the forward bias puzzle.

ASSIGNMENT: Chapter 5, Exercises 1, 3, 4, 5, and 6.

CASE: Ford Motor Credit Company

Week 4 Determination of Spot Exchange Rates: Theory and Evidence

RML, Chapter 6

TOPICS: Exchanges rates and macroeconomic news announcements, asset models of the spot exchange rate, the monetary model, the sticky-price monetary model, the portfolio balance model; Empirical evidence on exchange rate models, empirical evidence on the role of macroeconomic news and exchange rate movements.

QUIZ #1 – Chapters 1-5

Week 5 Foreign Exchange Market Efficiency

RML, Chapter 7

TOPICS: Theory of exchange market efficiency, interpreting efficient market studies, empirical evidence on spot market efficiency, technical trading models, empirical evidence on forward market efficiency.

ASSIGNMENT: Chapter 7, Exercises 1, 3 and 5.

Week 6 Foreign Exchange Rate Forecasting

RML, Chapter 8

TOPICS: Forecasting under pegged rates versus floating rates, short-run versus long-run forecasts, forecast performance evaluation -- accurate versus useful forecasts; Short-run forecasts: trends versus random walks; Long-run forecasts: evidence on mean reversion? Composite forecasts.

ASSIGNMENT: Chapter 8, Exercises 3 and 4.

Week 7 Eurocurrency Markets

RML, Chapter 9

TOPICS: Origins of the market, market dimensions and location, pricing Eurocurrency deposits and loans, risks of Eurocurrency deposits, interest rate risk in Eurocurrency loans, competitive responses to offshore markets, and approaches to regulating offshore markets; the Japan Premium.

ASSIGNMENT: Chapter 9, Exercises 2, 3, 4, and 5.

Eurobond Markets

RML, Chapter 10

TOPICS: Origins of the market, market dimensions and currency composition, regulatory and institutional features, primary market practices, the gray market, onshore-offshore arbitrage, pricing determinants of Eurobonds, competitive responses - the Rule 144a market.

Week 8 International Bond Markets and Portfolios

RML, Chapter 14

TOPICS: Dimensions of national bond markets, calculating hedged and unhedged returns on international bonds, the "free-lunch" notion in international bond funds, active versus passive currency risk management, empirical evidence on performance of international bonds portfolios; Brady bonds, Global bonds, incentives for issuers and investors to engage in global bonds.

ASSIGNMENT: Chapter 14, Exercise 1

International Equity Markets and Portfolios

RML, Chapter 15

TOPICS: Dimensions of national equity markets, growth, market capitalization, firm size, trading costs; Equity market segmentation – Role, causes and techniques for overcoming market; segmentation, American Depositary Receipt (ADR) market and trends in cross-listing, Global equity and Euro-equity markets; International portfolio diversification – Creating “homemade” international diversification. Are diversification gains steady or declining? Is the degree of market integration changing?

Week 9 Currency and Interest Rate Futures

RML, Chapter 11

TOPICS: Institutional differences between futures and forwards, the marking-to-market convention, payoff profiles of futures contracts, futures and hedging, the term structure of forward prices, currency risk premium in forwards, success and failure of new futures contracts, do futures markets affect cash market volatility?

ASSIGNMENT: Chapter 11, Exercises 1, 2, 3, and 4.

QUIZ #2 – Chapters 6-10, 14

Week 10 Currency and Interest Rate Options

RML, Chapter 12

TOPICS: Option terminology, contract specifications, payoff profiles of options, options and hedging, pricing spot currency options, the discrete time binomial option pricing approach (another replicating portfolio), the continuous time lognormal approach, empirical evidence on option pricing models, estimating volatility, historical versus implied volatility, managing the risks in option positions.

ASSIGNMENT: Chapter 12, Exercises 4, 6, 7, 8, and 9.

CASE: Gifts from FX Students

Week 11 Currency and Interest Rate Swaps

RML, Chapter 13

TOPICS: Origins of the swap market, measuring the size of the market, gross versus net measures of the market, basic cash flow requirements of currency and interest rate swaps, the swap as a collection of forward contracts (another replicating portfolio), risks of swaps, Measuring the risks of swaps, amortization and diffusion effects, price quoting conventions in swaps, pricing interest rate and currency swaps, sources of gains to the users of swaps, risk exposure and capital requirements for swaps dealers and counterparties, netting agreements, BIS capital requirements.

ASSIGNMENT: Chapter 13, Exercises 1, 2, and 10.

Week 12 International Cost of Capital and Capital Budgeting

Readings: TBA

TOPICS: Measuring cost of capital in an international context; Impact of market segmentation and liquidity on cost of equity capital; Global variations on the capital asset pricing model, WACC in multinational vs. domestic firms. Objective of international capital budgeting; why international capital budgeting is considered “special”, conditions when international and domestic capital budgeting are similar; Dealing with special international circumstances: Blocked funds, expropriation risks, etc.

Week 13-14 Measuring Exposure to International Financial Risks

RML, Chapter 16, pages 600-21

TOPICS: Macroeconomic risks and the value of the firm, direct and indirect economic exposures, accounting measures of exposure (translation and transaction exposure), economic measures of exposure (regression and scenario analysis).

ASSIGNMENT: Chapter 16, Exercise 3

Managing Exposures to International Financial Risks

RML, Chapter 16, pages 621-39; Chapter 17, pages 644-56.

TOPICS: Why should the firm hedge? Empirical evidence on the value of hedging, financial strategies toward risk management, selecting a suitable hedging instrument, picking the right hedge ratio, successful vs. flawed hedging strategies, the Value at Risk (VAR) approach, BIS regulations and the use of in-house VAR measures.

CASE: Jaguar, plc.

May 4 **FINAL EXAM, 8:00 – 9:50 a.m.**