

Course Outline

Foundations of Finance – EC5320

Course Leader – Vinay Nundlall

Autumn Term – 20 credits

Version 1.0

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AIMS

Foundations of Finance is designed to give students the rudimentary tools necessary for analyzing the financial markets and making financial decisions in the equity markets by training their intuition using technical, analytical and quantitative methods. The course introduces students to the foundations of the theory of choice under uncertainty and then familiarizes them with the modern theory of asset pricing. Thereafter, a general approach to asset valuation, which builds on state contingent prices, is adopted to introduce the fundamental concept of arbitrage pricing and the notion of market completeness. In the final part of the course, the topic of market microstructure is introduced with a hands-on approach to trading with a simulation software.

LEARNING OUTCOMES

By the end of this course, students should be able to:

- demonstrate knowledge of the theory of choice under uncertainty;
- create
- have a firm grasp of mean-variance analysis and be able to create an efficient portfolio by picking stocks;
- apply the theory of state prices to arbitrage;
- critically evaluate asset pricing models, in particular the Capital Asset Pricing Model (CAPM);
- critically evaluate the forms of market efficiency and how to test them;
- demonstrate knowledge of market microstructure and market designs.

COURSE DELIVERY

One 2-hour lecture and one 1-hour seminar class every week.

Course outline, lecture notes, problem sets, and readings will appear on Moodle.

ASSESSMENT

Formative assessment:

- Weekly problem sets and classes provide feedback. There will be one take home project of about 2,000 words which will be graded and returned with standardized feedback, although it will not have a formal weight. However it must be completed.

Summative assessment:

- One 2-hour unseen written exam taken during the summer term, contributing 75% towards the final mark.
- One in-class test contributing 25% of the final mark.

Deadlines and dates of tests will be confirmed in the Departmental Student Handbook and on the Economics Department Website.

READING

The main textbook for the course is:

T.E. Copeland, J.F. Weston and K. Shastri, *Financial Theory and Corporate Policy*, 4th Edition, Addison-Wesley, 2004.

You are strongly advised to purchase your own copy of the book. Further reading materials such as journal articles will be posted in Moodle.

TOPICS to be covered

Expected Utility Theory

Choice Under Uncertainty

Mean-Variance Portfolio Theory

Asset Pricing Models

Market Efficiency

State Preference Theory

Market Microstructure and Trading Mechanism