Master in Economics and Finance

Asset Pricing

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This course is an introduction to asset pricing and portfolio choice that covers both the main theories and empirical issues. We start with an overview of the functions of financial markets and intertemporal choice, first under certainty and then under uncertainty. Then, we develop static portfolio choice theory and classical asset pricing in discrete time (CAPM and APT) and discuss the main empirical results from testing these models. Next, we present the dynamic consumption-based capital asset pricing model (CCAPM) and discuss the related "equity premium puzzle". Finally, we discuss briefly bond pricing and the debate about market efficiency and investor rationality.

Throughout the course, we will focus on the economics of financial markets without being distracted by the details of the mathematical tools employed in most of the original finance literature. For this reason, we try to avoid the use of continuous-time stochastic models, which will be covered in the course on "Derivatives Pricing" to be held in the 3rd term.

Every other week, students will receive an assignment to be completed in one week's time (or more). The assigned problem set will be reviewed and discussed in an exercise session. Problem sets will contain theoretical as well as computational and empirical exercises. There will also be exercise sessions in which problems will be proposed and solved on the spot.

Topics:

1: Structure and Functions of Financial Markets

2: Choice under Uncertainty, Contingent Claim Markets

3: Static Portfolio Choice, Mean-Variance Analysis

4: Classical Asset Pricing: CAPM and APT

5: Consumption-Based Asset Pricing

6: Bond Pricing and Term Structure of Interest Rates

7: Market Efficiency and Investor Rationality

Textbooks:

Danthine, J.-P. and Donaldson, J., *Intermediate Financial Theory*, Prentice Hall, 2002.

Cochrane, J., *Asset Pricing*, Princeton University Press, 2001.

Bodie Z., Kane A. and Markus A.J., *Investments*, 3rd edition, Irwin Series in Finance, 1996.

Grading:

There will be a written final exam. Weekly assignments will count by 1/5 toward the overall grade.