**MBAD 733: FINANCE THEORY**

Over the past thirty years, Finance Theory (also referred to as Financial Economics) has risen as a major area of research within the wider field of economics. What is often overlooked is that the field started off as a branch of Business Administration before being taken up by economists. It is currently among the most active research areas in economics. It thus goes without saying that to get a good grasp of the course; students must thoroughly review microeconomics (e.g. utility theory) and Macroeconomics (e.g. asset pricing) principles. Some of the very useful prerequisites to this course may **NOT** have been adequately covered in the MBA Managerial Economics Course that you did earlier. Students are expected to do additional reading in these areas. In addition, students are expected to go through some of the classical and emerging research works in Finance that will be provided as the semester progresses.

**Objectives**

At the end of the semester, the student is expected to:

* Be conversant with the evolution of finance.
* Apply financial economics principles in the management of investments.
* Identify some gaps in financial economics that warrant further research.

The course will cover the following areas.

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| **TOPIC** | **REFERENCES** |
| 1. **INTRODUCTION.**    1. What is Finance Theory About?    2. Cornerstones of Finance Theory?    3. Landmarks in the Development of Finance. | (Lengwiler, 2004)**,** Introduction. |
| 1. **PREFERENCES AND UTILITY.**    1. Some Basic Assumptions.    2. Indifference Curves.    3. Ordinal versus Cardinal Utility.    4. Revealed Preference.    5. Time Inconsistent Preferences.    6. Utility and Satisfaction.    7. Indirect Utility and Consumer Preferences.    8. Marginal Utility.    9. The Utility Function.    10. Uncertainty.        1. Consumer Preferences.        2. Von Neumann- Morgenstern Utility.        3. Risk Aversion. | (Varian, 2010) Chapter 4.  (Pindyck & Rubinfeld, 1995) Chapter 3.  (Jehle & Reny, 2011) Chapters 1 and 2.  (Jones, 2008) Chapter 3.  (Wolfstetter, 1999) Chapter 6 (Risk Aversion). |
| 1. **STATE PREFERENCE THEORY.** | (Jones, 2008)Chapter 3. |
| 1. **PORTFOLIO THEORY.**    1. Introduction.    2. Portfolios as Synthetic Securities.    3. Risk-Return Tradeoff for a Portfolio with Two Assets.    4. Risk-Return Tradeoff for a Portfolio with N Assets. | (Bradfield, 2007), Part IV.  (Markowitz, 1952)**.** |
| 1. **CAPITAL MARKET THEORY (CMT).**    1. Introduction.    2. From Portfolio Theory to Capital Market Theory.    3. CMT Assumptions.    4. CAPM- Assumptions and Applications.    5. CAPM Extensions: CCAPM, Asset pricing with Production.    6. Arbitrage Pricing Theory. | (Reilly & Brown, 1999), Chapter 8. |
| 1. **FIXED INTEREST SECURITIES AND DURATION.**    1. Overview- Fixed Income Markets and Securities.    2. Players and their Objectives.    3. Fixed Income Securities: Types/ Classification.    4. Price-Yield Conventions.    5. Analytics of Fixed Income Markets. | (Sundaresan, 2009)**.** |
| 1. **VALUATION OF OPTIONS AND FUTURES.**    1. Introduction to Derivatives.    2. The Different Types of Derivative Securities.    3. Valuation of Options and Futures. | (Reilly & Brown, 1999) |
| 1. **SECURITIZATION.** | (Deacon, 2004) |
| 1. **SYNTHETIC SECURITIES.** | Lecture notes. |
| 1. **THE UNANSWERED QUESTIONS IN FINANCE.**    1. The Puzzles of Finance.    2. Other Prominent Questions in Finance. | Lecture notes. |

**EVALUATION**

**The course will be evaluated as follows;**

**2 assignments of 30 marks each 15**

**2 sit in CATS 15**

**End of Semester Exams 70**

**TOTAL 100**

# References

Bradfield, J. (2007). *Introduction to the Economics of Financial markets.* Oxford: Oxford University Press.

Deacon, J. (2004). *Global Securitiuzation and CDOs.* Chichester: John Wiley & Sons, LTD.

Jehle, G., & Reny, R. (2011). *Advanced Microeconomic Theory, Third Edition.* Edinburg: Pearson Education Limited.

Jones, C. (2008). *Financial Economics.* New York: Routledge.

Lengwiler, Y. (2004). *Microfoundations of financial economics: an introduction to general equilibrium asset pricing.* Princeton: Princeton University Press.

Markowitz, H. (1952). Portfolio Selection. *Journal of Finance, 7*(1), 77-91.

Pindyck, R., & Rubinfeld, D. (1995). *Microeconomics, Third Edition.* Beijing: Prentice Hall, Inc.

Reilly, F., & Brown, K. (1999). *Investment Analysis and Portfolio Management.* New York: Routledge.

Sundaresan, S. (2009). *Fixed Income Markets and their Derivatives.* London: Elsevier.

Varian, H. (2010). *Intermediate Microeconomics: A Modern Approach, 8th Edition.* New York: W.W. Norton & Company.

Wolfstetter, E. (1999). *Topics in Microeconomics: Industrial Organization, Auctions and Incentives.* Edinburgh: Cambridge University Press.