

$$\frac{20}{100} \times 1200 = 240$$

$$\frac{20}{100} \times 1000 = 200$$

$$\frac{1200}{240} = 5$$

76.785.

$$\frac{24}{100} \times 100 = 24$$

is/Jan/23 150  
3 WEEK 4  
Lesson #10

Recessions are substantially psychological.

Inverted yield curves → short term interest rates are higher than short term interest rate

↳ Statistically this is a leading high indicator of recessions.

Why? long-term pessimism is implied by the lower int. rate for longer durations.

In the past, short-term interest rates have been ↑ (thereby inducing recessions) in order to combat high inflation.

\* The stock market is also a leading indicator of recession.

- 1929 - stock mkt drop → followed by recession.



A financial bubble - price exceeds its fundamental value by a large margin.  
The bubble eventually breaks & massive selloffs cause price to decline.

### History of Mortgage Lending

Mortgage - the concept of lending someone money w/ a contract specifying certain collateral can be liquidated in case of defaulting.

Mortgage lending - enables people to lend by valuating collateral rather than trustworthiness.

\* the first clear regulated property ownership system was Grundbuch - Germany, 19<sup>th</sup> century  
29/6/23 Commercial Real Estate Vehicles

Real Estate Partnership - example of Direct Participation Program (for "accredited investors" only - investors who can invest high amts of money)  
Direct participation programs escape the corporate tax.

\* "pass through vehicles"  
- DPPs cannot be perpetual.

? Were there any housing bubbles in India?

Real Estate Investment Trusts (REITs) - allows small investors to invest in real estate (in the US.)

Several restrictions on REITs to discourage companies trying to pass off as REITs.

\* if there's no psychological influences, real estate prices would be representative of construction prices.

### MORTGAGES

going "underwater" - house becomes less worth, rise in unemployment compared to the value of the mortgage.

US Federal Housing Administration  
\* US govt insures banks against defaulters of mortgages  
\* long term mortgages

Private Mortgage Insurance (PMI)  
↳ mortgagors buy mortgage insurance if down payment is less than 20%.



~~Centralized~~ Collateralized Mortgage Obligations (CMOs)  
→ pool of mortgages sold to investors; divided into tranches

Collateralized Debt Obligations  
→ several mortgage securities as assets.

30 June, 2023

Post Crisis Regulation

"liar's loan": banks started approving all loans since mortgages were going to be sold to ignorant investors  
→ loans given to people who have high probability to default.

→ Europe: 5% of mortgages must be held by the originator  
US - 5% to be held by originator unless it's a "Qualifying Residential Mortgage".

Excess Reserves - banks have to keep a certain amount of cash as reserve, what they hold beyond what's reqd. is called "excess reserve".

\* Excess reserves held by banks have been increasingly higher after recession since the interest rate is very low.

- one major cause - moral hazard & selection bias.

The Bubble - Part ①

home prices - 2000 (overpricing of home prices)

2012 - home prices crashed again

\* logically, home prices must always go up, right? why don't they?

Building technology is getting better & better  
land ~~comp~~ price is a small component of home prices

???



New housing projects in 2007 increased dramatically & then fell to a record low when the price of homes collapsed.

### Bubble-Part ③

measures of valuation of real estate:

- price to income ratio
- rate of appreciation
- price of land relative to GDP

### Salon-Bubbles:

- historical determinism
- should you invest during a bubble?
- Edward Miller - efficient markets theory cannot hold unless short selling is possible since crazy people will bid certain stocks up?
- short selling for real estate

5 levels of regulation  
① w/i firm      ④ national govt  
② trade grps.      ⑤ international regulation  
③ local govt

### 02/07/2023 LESSON #11

Regulation - aimed at dealing w/ manipulation & deception.

\* in a competitive market w/ narrow profits, if everyone is doing it, you have to do it as well.

Microprudential regulation

- aimed @ safeguarding single individual/business.

Macroprudential regulation

- aimed @ preventing big crises (since 2008 fin crisis)

dodd frank → debt payments must not exceed 43% of income.

### WITHIN FIRM REGULATION

board of directors acts like a regulator. Outside directors give perspective & views of community.

Tunneling - people steal money from their company.

→ more common in civil law countries than common law countries (common law - new laws from courts - precedent)

How is tunneling achieved?

- Asset sales, contracts (pay too much for a service), excessive executive compensation, loan guarantees, expropriation of corporate opportunities, dilutive share issues, insider trading

### Duties of Directors

1) Duty of Loyalty (must represent interest of shareholders)

2) Duty of Care (must act rationally)

### Trade Groups

First Agreement (1792) - fixed commission & preference of brokers

### Local Regulation

banking regulation belonged to the states still 1863

1934 - set up the SEC

Corporate law still belongs to the state govts

Blue Sky laws - to protect public from fraud

### National Regulation

Corruption gradually reducing is part of the growth of the country. Strict & more regulation is part of a country's growth.

SEC enforces disclosure, which definitely helps reduce fraud

clear, concise & standardized way - major thing SEC did.

### Public vs Private Securities (IPO)

private company example - hedge funds

every broker, stock exchange & security issue must be registered w/ the SEC

### 2) Insiders vs. Outsiders

Self Regulatory Organizations

- take care of insider trading regs by themselves instead of SEC.



Front-running → when a broker buys shares in front of a large order that will boost stock prices.

\* Decimalization (?)

(3) Accounting Standards are set up by SEC.

- Generally Accepted Accounting Principles (GAAP).

(4) SIPC → Securities Investor Protection Corporation

- protects customers of brokerage firm against failure upto certain \$ per account or certain \$ in cash.

\* 2008 fin crisis is probably bc of regulatory failure.

⇒ Dodd Frank Act, European Supervisory Framework.

INTERNATIONAL REGULATIONS

Central bank for central bankers:

Bank for International Settlements

- 1930, Hague Agreements.