Economics 270

Financial Decisions

The first part of the course introduces the cornerstone of modern asset pricing, i.e. the pricing kernel or stochastic discount factor model. Standard theories of bond prices and exchange rates can be viewed as special cases of this model. This model serves as the benchmark for many subsequent topics, including performance evaluation models.

The second part of the course studies cross-sectional and time-series implications of the pricing kernel model for asset returns and reviews a variety of empirical asset pricing puzzles or anomalies. The third part of the course covers basic continuous time finance and option pricing, including the Black Scholes option pricing equation.

The course covers a broad range of topics and students are required to consult journal articles for additional readings. Some of the course material is covered in


Introductions to theory and empirical tests of asset pricing models are provided in


Additional recommended texts include

I. Asset Pricing

**Pricing Kernel/Stochastic Discount Factor model**

Cochrane, 2005, chapters 1-4, pages 1-75.


**Background readings**


**Mathematics of the Portfolio Frontier, Two Fund Separation**


**Background readings**


**CAPM**


**Background readings**


**Factor Pricing Models**


Background readings


II. Empirical Modeling of Asset Prices

Empirical Evidence on the CAPM and the APT


Background readings


The Present Value Model


Background readings


Predictability of Returns


Background readings


**Event Study Analysis**


**Measuring Portfolio Performance**


**Background readings**


III. Option Pricing

Option Contracts, Payoffs and Investment Strategies, Pricing Bounds


Background readings


Ross, Stephen A., 1976, Options and Efficiency, Quarterly Journal of Economics 90, pp. 75-89.

The Binomial Lattice Model


Background readings


**Introduction to Continuous Time Finance**


Background readings


**The Black-Scholes Option Pricing Model**


**Background readings**

