

November 12, 2012

Economics 252
Financial Markets
Fall 2012
(Subject to change)

Prof. [Robert J. Shiller](#) (Room 11a, 30 Hillhouse, Office Hours usually Monday 3-5pm)

Administrative Assistant: [Carol Copeland](#) (Room 10, 30 Hillhouse, 203 432-3726)

Teaching Assistants: [Alidad Damooei](#) (Head TA) (TF2, Wed 10:30, Mid1), [A.Z. Biazar](#) (TF4, Thurs 1:30, 2:30, Mid2), [Paul Connell](#) (TF2, Wed 5:30, Final) [Federico Esposito](#) (TF4, Tues 4:00, 5:00, Mid2, Final), [Charles Hauch](#) (TF2, Mon. 7:00, Mid1)

Classroom: WLH 201 (the large auditorium, Sudler Hall) 9am-10:15am Mondays and Wednesdays (with six Friday teaching assistant lectures)

Course Description: Financial institutions are a pillar of civilized society, directing resources across space and time to their best uses, supporting and incentivizing people in their productive ventures, and managing the economic risks they take on. The workings of these institutions are important to comprehend if we are to predict their actions today and their evolution in the coming information age. The course strives to offer understanding of the theory of finance and its relation to the history, the strengths and imperfections of such institutions as banking, insurance, securities, futures, and other derivatives markets, the problems and crises with these institutions, the moral issues that financial practitioners face, and the future of these institutions over the next century.

In both 2008 and 2011 the lectures of this course were recorded and are available for free to the general public on Open Yale Courses. The 2011 lectures can be found at <http://oyc.yale.edu/economics/econ252-11>. In the syllabus below I point out lectures from 2011 that are relevant to the day's lecture, and suggest that students might familiarize themselves with that material before the lecture, using the transcript, the mp3 audio file, the low bandwidth video

or the high bandwidth video that are available there. That way I hope to have some more class interaction, even though this tends to be a large class.

Grading Weights: 10% problem sets, 20% first midterm, 30% second midterm, 40% final (subject to judgmental adjustment)

Guest lecturers:

Dean Takahashi, Senior Director of Investments, Yale University,

Eddie Lampert, Founder ESL Securities, Chairman Sears Holdings

Jon Fougner, Yale Law School

Textbooks:

Frank J. Fabozzi, Franco Modigliani and Frank J. Jones, *Foundations of Financial Markets and Institutions*, 4th ed., Prentice Hall, 2010.

Robert J. Shiller, *Finance and the Good Society*, Princeton University Press, 2012.

Lectures and Readings (* denotes optional reading; if a book, on reserve at Bass Library)

Lecture 1: Introduction: Finance as the Science of Goal Architecture Wednesday August 29

*[Shiller Open Yale Lecture 1](#) Introduction and What this Course Will Do for You and Your Purposes

Fabozzi, *Foundations of Financial Markets and Institutions*, Chapters 1,p. 1-11, Introduction, Chapter 2, Financial Institutions, Financial Intermediaries, and Asset Management Firms, pp. 21-38

Shiller *Finance and the Good Society* , [Preface, pp. vii-xiii](#), [Introduction](#), pp. 1-15, Chapter 18, Philanthropists, pp. 124-7, Chapter 19, Finance, Mathematics and Beauty, pp. 135-8

Carnegie, Andrew, [The Gospel of Wealth and Other Timely Essays](#), New York: The Century Company, 1901, pp. 1-46, “The Gospel of Wealth (1889).” ([Excerpts in Carnegie’s voice in 1914 Thomas Edison audio file](#) click on “web exclusive audio” below)

*[“The Gospel of Wealth”](#) (Review) *San Francisco Chronicle*, February 9, 1890, p. 4.

Lecture 2: The Multitude of Roles and Responsibilities that Make Up the Financial Community, and How They Build Modern Society Friday August 31 (Note extra lecture because there won’t be class Monday Labor Day)

Shiller, *Finance and the Good Society*, Part I, Chapters 1-9, pp. 19-86.

Lecture 3: Risk and Financial Crises Wednesday September 5

*[Shiller Open Yale Lecture 2](#) “Risk and Financial Crises”

Shiller, *Finance and the Good Society* Chapter 25, The Significance of Financial Speculation, pp, 168-77, Chapter 26 Speculative Bubbles and their Costs to Society, pp. 178-86

Gary Gorton, [“Slapped in the Face by the Invisible Hand: Banking and the Panic of 2007,”](#) Federal Reserve Bank of Atlanta Financial Markets Conference, 2009

Teaching Assistant Session 1: Review of Probability Friday September 7, Problem Set #1 distributed, Charles Hauch

Lecture 4: Technology and Invention in Finance Monday September 10

*[Shiller Open Yale Lecture 3](#) Technology and Invention in Finance”

Shiller, *Finance and the Good Society*, Chapter 8, Market Designers and Financial Engineers, pp. 69-74.

*Sandor, Richard L., *Good Derivatives: A Story of Financial and Environmental Innovation*, Wiley 2012

Lecture 5 Portfolio Diversification and Supporting Financial Institutions Wednesday September 12 [Oliver Bunn, last year's head teaching assistant, will give this lecture] Problem set 1 due

[*Shiller Open Yale Lecture 4](#) "Portfolio Diversification and Supporting Financial Institutions"

Fabozzi, *Foundations of Financial Markets and Institutions*, Chapter 12, Risk/Return and Asset Pricing Models pp. 241-68

*Jeremy Siegel, *Stocks for the Long Run*, Chapters 1 and 2, Reserve, Bass

Teaching Assistant Session 2: Capital Asset Pricing Model Friday September 14, Problem Set #1 due in class, Problem Set #2 distributed, Federico Esposito

Lecture 6: Insurance Monday September 17 (beginning of first review section week)

[*Shiller Open Yale Lecture 5](#), "Insurance, the Archetypal Risk Management Opportunities, its Opportunities and Vulnerabilities"

Fabozzi, *Foundations of Financial Markets and Institutions*, Chapter 6, Insurance Companies, pp 95-120

Shiller, *Finance and the Good Society*, Chapter 7, Insurers, pp. 64-8

*Geoffrey Etherington *et al.* [Dodd Frank: The Road Ahead: Insurance](#), Bloomberg Law Reports 2012

*Michel-Kerjan, Erwann O., Paul A. Raschky and Howard Kunreuther, [“Do Firms Manage Catastrophe and Non-Catastrophe Risks Differently?”](#) University of Pennsylvania, Wharton School Working Paper

Guest Speaker Wednesday September 19

[Dean Takahashi](#), Senior Director of Investments, Yale University

(Friday September 21, Problem Set #2 due, either delivered to the box by Carol Copeland’s office (Room 10 30 Hillhouse, to Federico Esposito’s box in the mailroom of 28 Hillhouse (Economics Department) or emailed to the head TA, Alidad Damooie) .

Lecture 7: Efficient Markets Monday September 24 (beginning of second review section week)

*[Shiller Open Yale Lecture 7](#) Efficient Markets

Conant, Charles A. [Wall Street and the Country: A Study of Recent Financial Tendencies](#), New York, G.P. Putnam’s Sons, 1904, Chapter 3, The Function of the Stock and Produce Exchanges, pp. 83-116

Shiller, *Finance and the Good Society*, Chapter 25, The Significance of Financial Speculation, pp. 168-77, Chapter 26, Speculative Bubbles and their Costs to Society, pp. 178-86

*Lehrer, Jonah, [“The Truth Wears Off: Is there Something Wrong with the Scientific Method?”](#) [The New Yorker](#), December 13, 2010, pp 52-57.

*Swensen, David, *Pioneering Portfolio Management*, Chapter 8, Alternative Asset Classes (Reserve Bass)

Midterm Exam 1

Wednesday September 26

Lecture 8: Theory of Debt, Its Proper Role, Leverage Cycles Monday, October 1

*[Shiller Open Yale Lecture 8](#) “Theory of Debt, It Proper Role, Leverage Cycles

Fabozzi, *Foundations of Financial Markets and Institutions*, Chapter 9, Properties and Pricing of Financial Assets, pp. 170-90, Chapter 10, The Level and Structure of Interest Rates, pp. 191-216, Chapter 11, The Term Structure of Interest Rates, pp. 217-40, Chapter 19, pp. 399-413 Markets for Corporate Senior Instruments I, Chapter 20, Markets for Corporate Senior Instruments II, pp. 414-36

Shiller, *Finance and the Good Society*, Chapter 23, Debt and Leverage pp. 151-8

* Sullivan, Teresa, Elizabeth Warren and Jay Lawrence Westbrook, *The Fragile Middle Class: Americans in Debt*, Yale University Press, 2000

Lecture 9: Corporate Stocks Wednesday October 3

*[Shiller, Open Yale Lecture 9](#) Corporate Stocks

Fabozzi, *Foundations of Financial Markets and Institutions*, Chapter 17, Markets for Common Stock: The Basic Characteristics, pp. 334-63, Chapter 18, Markets for Common Stock, Structure and Organization, pp. 364-98

Lecture 10: Real Estate Monday October 8

*[Shiller, Open Yale Lecture 10](#) “Real Estate”

Fabozzi, *Foundations of Financial Markets and Institutions*, Chapter 22, the Residential Mortgage Market, pp. 447-63, Chapter 23, Residential Mortgage-Backed Securities Market, pp. 464-94, Chapter 24, Market for Commercial Mortgage Loans and Commercial Mortgage-Backed Securities, pp. 495-504, Chapter 25, Asset-Backed Securities Markets, pp. 505-521

Shiller, *Finance and the Good Society*, Chapter 5, Mortgage Lenders and Securitizers, pp. 50-56

Foote, Christopher, Kristopher S. Gerardi and Paul S. Willen, "[Why Did So Many People Make So Many Ex Post Bad Decisions? The Causes of the Foreclosure Crisis](#)" Federal Reserve Bank of Boston, 2012.

Lecture 11: Behavioral Finance and the Role of Psychology Wednesday October 10

*[Shiller Open Yale Lecture 11](#) "Behavioral Finance and the Role of Psycholog"

Shiller, *Finance and the Good Society*, Chapter 20, Categorizing People: Financiers vs. Artists and Other Idealists pp. 135-8, Chapter 21, An Impulse for Risk Taking, pp. 139-42, Chapter 22, "An Impulse for Conventionality and Familiarity pp. 143-50

*Kahneman, Daniel, *Thinking Fast and Slow*, Farrar, Straus and Giroux, 2011.

*Pinker, Daniel, *The Better Angels of Our Nature: Why Violence Has Declined*, Viking Adult, 2011.

Teaching Assistant Session #3: Term Structure of Interest Rates Problem Set #3 distributed, Alidad Damooie, Friday October 12

Lecture 12: Misbehavior, Crises, Regulation and Self Regulation Monday October 15

*[Shiller Open Yale Lecture 12](#) "Misbehavior, Crises, Regulation and Self Regulation

Shiller, *Finance and the Good Society*, Chapter 12, Regulators pp. 94-99, Chapter 13, Accountants and Auditors, pp. 100-102, Chapter 24, "Some Unfortunate Incentives to Sleaziness Inherent in Finance" pp. 159-67

*World Economic Forum, [Partnering to Strengthen Public Governance](#), Geneva, 2008

*Johnson, Simon, Rafael La Porta, Florencio Lopez-di-Silanos, and Andrei Shleifer, "[Tunneling](#)," *American Economic Review*, 2000, **90**(2):22-7. (JSTOR)

Lecture 13: Banks Wednesday October 17

*[Shiller Open Yale Lecture 13](#) Banks

Fabozzi, *Foundations of Financial Markets and Institutions*, Chapter 3, Depository Institutions: Activities and Characteristics, pp. 39-60, Chapter 21, The Markets for Bank Obligations, pp. 437-46

Shiller, *Finance and the Good Society*, Chapter 3, Bankers pp. 37-44

*[European Debt Crisis Timeline](#), *New York Times*, November 6, 2011

*[Timeline: Barclays' Widening Libor-Fixing Scandal](#), BBC News, July 17, 2012

*Scott, Kenneth, "[Dodd-Frank: Resolution or Expropriation](#)?" Hoover Institution, Stanford University, 2012.

Teaching Assistant Session #4: Real Estate Finance Friday October 19, Problem Set #4 distributed, Problem Set #3 due, A.Z. Biazar

Lecture 14: Forward and Futures Markets Monday October 22 (Problem Set #4 due in class, beginning of third review section week)

*[Shiller Open Yale Lecture 15](#), "Forwards & Futures"

Fabozzi, *Foundations of Financial Markets and Institutions*, Chapter 26, Financial Futures Markets, pp. 522-40, Chapter 28 Pricing of Futures and Options Markets, pp. 566-73

"[A Long Road to Regulating Derivatives](#)," *The New York Times*, March 24, 2012.

*Working, Holbrook, "[Futures Trading and Hedging](#)," *American Economic Review*, June 1953, pp. 314-43. Reprinted in *Selected Writings of Holbrook Working*. (JSTOR)

*Melamed, Leo, *For Crying Out Loud: From Open Outcry to the Electronic Screen* Wiley, 2009.

October Recess, October 24-8

[Hurricane Sandy forced cancellation of class October 29]

Lecture 15: Options Markets Wednesday October 31, Problem Set #4 due

*[Shiller Open Yale Lecture 17](#), Options Markets

Shiller, *Finance and the Good Society*, Chapter 9, Derivatives Providers, pp. 75-80

Shefrin, Hersh, and Meir Statman, "[Behavioral Aspects of the Design and Marketing of Financial Products](#)", *Financial Management*, 22(2):123-34, 1993.

Guest Lecture Eddie Lampert November 5 (Note: this lecture is in SSS 114, not our usual classroom)

Mark Bastow, "[Eddie Lampert Has a Master Plan](#)" *Forbes* August 2012

Midterm Exam 2 Wednesday November 7 (rescheduled because of hurricane)

Lecture 16: Monetary Policy Friday, November 9 Problem Set #5 distributed

*[Shiller Open Yale Lecture 18](#) "Monetary Policy"

Fabozzi, *Foundations of Financial Markets and Institutions*, Chapter 4, The U.S. Federal Reserve and the Creation of Money, pp. 61-76, Chapter 5, Monetary Policy, pp. 77-94

Shiller, *Finance and the Good Society*, Chapter 16, Policy Makers in Charge of Stabilizing the Economy, pp. 111-118

*Walter Bagehot, [*Lombard Street: A Description of the Money Market*](#), New York: Scribner, Armstrong & Co, 1873. Chapter 2, A General View of Lombard St., p. 21-73.

Lecture 17: Investment Banks Monday November 12, beginning of fourth review section week with special appearance of Jon Fougner, former Econ 252 student, who has since worked at Goldman Sachs and Facebook

*[Shiller Open Yale Lecture 19](#) Investment Banks

Fabozzi, *Foundations of Financial Markets and Institutions*, Chapter 13, Primary Markets and the Underwriting of Securities, pp. 269-81

Shiller, *Finance and the Good Society*, Chapter 4, Investment Bankers, pp. 45-9

*Ellis, Charles, *The Partnership: The Making of Goldman Sachs*, London, Penguin, 2008, Chapter 11 Principles. (Reserve Bass)

Teaching Assistant Session 5: Futures Markets Wednesday November 14, A. Z. Biazar

Teaching Assistant Session 6: Options Markets Friday November 16, Problem Set #6 distributed, Paul Connell

Thanksgiving Recess, November 17-25

Lecture 18: Professional Money Managers and their Influence Monday November 26

*[Shiller Open Yale Lecture 20](#) “Professional Money Managers and their Influence”

Fabozzi, *Foundations of Financial Markets and Institutions*, Chapter 7: Investment Companies and Exchange Traded Funds, pp. 121-54, Chapter 8, Pension Funds pp. 155-69.

Shiller, *Finance and the Good Society*, Chapter 2, Investment Managers pp. 27-36.

*O.Barr, William M. and John M. Conley, *Fortune and Folly: : The Wealth & Power of Institutional Investing*, Business-One Irwin, Homewood Illinois, 1992

Lecture 19: Exchanges, Brokers, Dealers, Clearinghouses Wednesday November 28
(Problem Set #5 and #6 due)

*[Shiller Open Yale Lecture 21](#) “Exchanges, Brokers, Dealers, Clearinghouses”

Fabozzi, *Foundations of Financial Markets and Institutions*, Chapter 14, Secondary Markets, pp. 282-93

Shiller, *Finance and the Good Society*, Chapter 6, Traders and Market Designers pp. 50-56.

*Commodity Futures Trading Commission and Securities Exchange Commission, [Findings Regarding the Market Events of May 6, 2010](#), Report to the Joint Advisory Committee on Emerging Regulatory Issues, Washington DC: U.S. Commodity Futures Trading Commission, September 30, 2010

Lecture 20: Public Finance Friday November 30 (extra Friday lecture making up for lecture missed because of Hurricane)

*[Shiller Open Yale Lecture 22](#), “Public and Nonprofit Finance”

Fabozzi, *Foundations of Financial Markets and Institutions*, Chapter 15, Treasury and Agency Securities Markets, pp. 294-319, and Chapter 16, Municipal Securities Markets, pp. 320-33

Shiller, *Finance and the Good Society*, Chapter 15, Public Goods Financiers, pp. 107-10,

*Seligman, Edwin R. A., [The Income Tax: A Study of the History, Theory, and Practice of Income Taxation at Home and Abroad](#), 2nd Edition, New York: MacMillan, 1914.
Chapter 1, The Development of a Norm of Taxation, p. 3, Chapter 2, Property as a Test of Faculty, p. 6, Chapter 3, Expenditure and Product as Tests of Faculty, p. 10, Chapter 4, Income as a Test of Faculty, pp 15-18, Chapter 8 The Graduation of Taxation, pp. 29-33.

Lecture 21: Nonprofits, Cooperatives, Philanthropy Monday December 3 (beginning of sixth review section week)

*[Shiller Open Yale Lecture 22](#), “Public and Non-Profit Finance”

Shiller, *Finance and the Good Society* Chapter 17, Trustees and Nonprofit Managers, pp. 119-23, Chapter 18, Philanthropists, Chapter 28, Problems with Philanthropy

Quincy, Josiah, “Co-operative Societies,” *Christian Union*, January 21, 1880, p. 52. (via [Proquest](#))

Lecture 22: Finding your Purpose in a World of Financial Capitalism Wednesday December 5

*[Shiller Open Yale Lecture 23](#), “Finding your Purpose in a World of Financial Capitalism”

Shiller, *Finance and the Good Society*, Chapter 27, Inequality and Injustice, pp. 187-96, Chapter 30, The Great Illusion Then and Now, pp. 219-29, Epilogue: Finance, Power and Human Values, pp. 231-39

*Unger, Peter, [Living High and Letting Die: Our Illusion of Innocence](#), New York: Oxford University Press, 1996

*Sumner, William Graham, [What the Social Classes Owe Each Other](#), New York: Harper Brothers, 1883, Chapter III, “That It Is Not Wicked to Be Rich,” pp. 43-57.