

Semester VI
B.A. (Honours) Economics
DSE 7 (Group-II): FINANCIAL ECONOMICS (6 Credits)
Full marks: 100 (Mid Term-20 + End Term-80)

Course Description

This course introduces students to the economics of finance. Some of the basic models used to benchmark valuation of assets and derivatives are studied in detail; these include the CAPM, and the Binomial Option Pricing models. The course ends with a brief introduction to corporate finance

Units		No of Lecture Hours	No of Tutorial Hours	Marks
1.	Investment Theory and Structure of Interest rates: Deterministic cash-flow streams: Basic theory of interest; discounting and present value; internal rate of return; evaluation criteria; fixed-income securities; bond prices and yields; interest rate sensitivity and duration; immunisation; the term structure of interest rates; yield curves; spot rates and forward rates.	20	4	20
2.	Models of Single-period random cash flows: Random asset returns; portfolios of assets; portfolio mean and variance; feasible combinations of mean and variance. Mean-variance portfolio analysis: the Markowitz model and the two-fund theorem; risk-free assets and the one-fund theorem.	15	3	15
3.	Capital Asset Pricing Model: The Cost of Capital: Debt and equity; Cost of Debt, Cost of Preference Capital and Equity Capital. The capital market line; the capital asset pricing model; the beta of an asset and of a portfolio; security market line; use of the CAPM model in investment analysis and as a pricing formula.	15	3	15
4.	Options and Derivatives: An introduction to financial derivatives: Types and uses of derivatives; Forward Contracts: Relation between Spot and Future Prices, forward vs future contract, Hedging in Futures; Options: types, value of an option, the Pay-Offs from Buying and Selling of Options.	15	3	20
5.	Corporate Finance: Corporate Financing: Meaning and its Patterns ;common stock; debt; preferences; convertibles.	10	2	10
Total		75	15	80

Reading List:

1. David G. Luenberger, *Investment Science*, Oxford University Press, USA, 1997.
2. Hull, John C., *Options, Futures and Other Derivatives*, Pearson Education, 6th edition, 2005.

3. Thomas E. Copeland, J. Fred Weston and Kuldeep Shastri, *Financial Theory and Corporate Policy*, Prentice Hall, 4th edition, 2003.
4. Richard A. Brealey and Stewart C. Myers, *Principles of Corporate Finance*, McGraw-Hill, 7th edition, 2002.
5. Stephen A. Ross, Randolph W. Westerfield and Bradford D. Jordan, *Fundamentals of Corporate Finance*. McGraw-Hill, 7th edition, 2005.
6. Burton G. Malkiel, *A Random Walk Down Wall Street*, W.W. Norton & Company, 2003.
7. William Sharpe, Gordon Alexander and Jeffery Bailey, *Investments*, Prentice Hall of India, 6th edition, 2003.