

BOSTON COLLEGE  
Department of Economics

Ec. 380.01  
Capital Theory and Finance  
Fall, 1996

Harold Petersen  
McGuinn 518, x4550  
Office Hrs. M 2, W 1, Th 4

Texts: Fabozzi, Frank J., and Modigliani, Franco. Capital Markets, Institutions and Instruments, 2nd ed., 1996.  
Lynch, Peter. Learn to Earn: A Beginner's Guide to the Basics of Investing and Business, 1995.  
Lynch, Peter. On Up on Wall Street, 1989.  
Malkiel, Burton. A Random Walk Down Wall Street, 6th ed., 1996.  
Haugen, Robert A. The New Finance: The Case Against Efficient Markets, 1995.

Course Requirements and Grading:

Two midterm exams (20% apiece), **October 1** and **November 19**  
An investment research report (20%), Part I due **October 17** and the complete report on **December 3**  
A final exam (40%), Saturday, **December 14**, at 12:30 p.m.)  
Problem Sets in the first part of the course (optional but strongly encouraged) will be recorded for extra credit if done well.

Course Organization and Expectations:

The course works best if pursued as a joint enterprise where the student contributes as much as the instructor. I expect to work hard at the course and I expect as much from you. This means coming to class, reading the assigned materials, working through the problem sets, and raising questions on material you find difficult or confusing. You will find me available outside of class, with sign-up times for appointments posted on my door, and you will find me more than willing to help if you are doing your share as well. I also expect you to read the financial pages of the newspaper, and to generate discussion on current topics as they develop.

You are encouraged to work together on the problem sets if you like, to discuss your investment briefs with each other, and to study together. Your work on exams is to be entirely your own, and on your investment brief anything drawn from others should be carefully cited. Be sure you are familiar with the section on "Academic Honesty" in the undergraduate catalog (p. 18) and be aware that I take this most seriously.

Good luck. It should be fun.

Syllabus

Topics

Readings\*

I. Introduction.

- A. Capital theory and tradeoffs over time.
- B. Financial markets and economic efficiency.
- C. Discounting, present value, and compound interest arithmetic.

Fabozzi, ch. 1  
Lynch (Learn/Earn),  
entire book  
Malkiel, Chs. 1-3

## II. Investment Criteria and Pricing of Assets.

- A. Present value and internal rate of return
- B. Rate of return: an application to yield to maturity on a bond. Fabozzi, ch. 17
- C. Valuation: an introduction to common stock pricing models. Malkiel, ch. 4

## III. Accounting Problems: Measurement of Earnings and Rate of Return.

- A. Financial statements. Lynch(L/E), App'x. 2
- B. The importance and use of earnings data. Friedman, esp.
- C. Depreciation, intangibles, and earnings bias. pp. 26-27.
- D. Inflation accounting.

## IV. Financial Markets.

- A. Investment banking, securities exchanges, the role of the specialist Fabozzi, chs. 5-6  
Guzzardi, Uttal
- B. Investment strategies: fundamentalists, technicians, and random walk. Malkiel, chs. 5-7  
Fabozzi, ch. 7
- C. The efficient market hypothesis, and some apparent inconsistencies Fabozzi, ch. 13  
Malkiel, ch. 8
- D. Financial innovations, volatility, regulation and reform Malkiel, ch. 11  
Fabozzi, ch. 15
- E. Tobin's "Q" and investment.

## V. Portfolio Selection.

- A. Diversification and risk reduction. Malkiel, chs. 9-10,
- B. The Sharpe-Lintner model. Fabozzi, chs. 8-9.
- C. The Capital Asset Pricing Model. Haugen, entire book.
- D. Risk and return: a summing up.

\*Complete citations to the readings are given below. They may all be found, save for those by Lynch and Malkiel, on reserve in the O'Neill library. In addition to the readings listed above, Peter Lynch's One Up on Wall Street should be read throughout the course. Pay particular attention to Lynch's One Up on Wall Street in doing your investment brief.

### Reserve Readings (O'Neill Library)

Friedman, Jesse. R&D Intensity in the Pharmaceutical Industry, Jesse J. Friedman and Associates, Washington, D.C., September, 1973.

Guzzardi, Walter. "The Bomb I.B.M. Dropped on Wall Street," Fortune, November 19, 1979, pp. 52ff.

Uttal, Bro. "Inside the Deal that Made Bill Gates \$350,000,000," Fortune, July 21, 1986, pp. 23ff.

### Periodicals and T.V.

The Wall Street Journal, daily, Monday through Friday. Excellent coverage of financial and economic news.

Forbes, biweekly. Perhaps the best of the magazines specializing in finance.

Wall Street Week, Public Broadcasting Service, Channel 2 in Boston, Fridays at 8:30 p.m. Good T.V. coverage of the world of investment and finance.

Business Morning (6:00 a.m. and 6:30 a.m.), Cable News Network, Monday through Friday. Excellent early morning coverage of financial news.

### Data Sources

The Value Line Investment Survey. Financial data for the past 15 years for a large number of widely traded firms, updated quarterly. (reserve desk, O'Neill)

Security Owner's Stock Guide, Standard and Poor's. Less information but on more firms than Value Line, updated monthly (periodicals room, O'Neill).

Barrons. Good source of current information re. earnings, dividends, recent developments on a large number of firms (periodicals room, newspaper rack).

Standard and Poor's Industry Surveys, fundamental analysis, plus additional data, on a large number of firms (reserve desk, O'Neill).

Moody's Manuals. Detailed background and financial information on most publicly traded firms (reference section, O'Neill).

Bloomberg Financial Services. On line data and research reports (Electronic Information Area, O'Neill)

Dow Jones News Retrieval Service. On line data and financial news on widely-traded firms (Electronic Information Area, O'Neill).

First Call Research Network. On line data and financial news on widely traded firms (Electronic Information Area, O'Neill).

Laser Disclosure. Recent annual reports, 10-K and proxy statements of publicly traded firms, on compact disks, (Electronic Information Area, O'Neill)

Internet. A huge and growing number of sources for market quotes, company reports, and financial news. Let's share information on what is good.