Debt and Money Markets (FIN 4243), Spring 2008
University of Florida, Warrington College of Business

Professor: Andy Naranjo, Emerson/Merrill Lynch Professor of Finance
Associate Director of CIBER

Office Location: 309C Stuzin Hall (in suite 309)

Office Hours: Tuesday and Thursday: 9:30 – 10:00;
Also after class & by appointment

EMAIL Address: Andy.Naranjo@Cba.Ufl.Edu

Contact Phone Numbers:
Office: (352) 392-3781
Secretary: (352) 392-0153
Fax: (352) 392-0301

Course Website: logon to E-Learning system (http://lss.at.ufl.edu/)
(Note: a link to the WebCT system can also be found on the College’s homepage)

Required Course Material:
1. Miles Livingston, Bonds and Bond Derivatives, 2005 (2nd Edition)
2. Course packet -- available at Target Copy
3. Class lecture slides are available on the course website -- see WebCT above
(some class handouts will also be distributed throughout the term)
4. A basic financial calculator for in-class problems, assignments, and exams (i.e., HP 10bII)

Course Description: (undergraduate catalog)
Financial markets; institutions and instruments associated with debt funds;
the determinants of the general level and structure of interest rates.

Course Requirements and Evaluation:
All assigned readings in the attached course outline are required. These
reading assignments will serve as background material for the lectures and should be
read prior to the class meetings. Class attendance and accompanying participation
are therefore critical components of the course. Taken together, the course readings,
lectures, and assignments serve as a strong foundation for understanding debt and
money markets.
There will be a total of 350 possible points that can be earned during the semester. These points are distributed among classroom participation (which also includes some in and out of class assignments), two homework assignments, and two exams.

Classroom participation is worth a total of 50 points and will be determined by relevant and meaningful classroom participation during the course lectures and other in-class assignments. Please note that classroom participation cannot be made up. The first exam is worth 140 points, and the second exam is worth 140 points. The homework assignments are worth 10 points each, for a total of 20 possible homework points. The homework assignments will be given before each of the exams to help prepare you for each exam.

Course Grade Scale:
Your course grade will be based on the following accumulative point scale:

<table>
<thead>
<tr>
<th>Grade</th>
<th>Accumulative Course Points</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>322 – 350 (92-100%)</td>
</tr>
<tr>
<td>B+</td>
<td>312 – 321 (89-91%)</td>
</tr>
<tr>
<td>B</td>
<td>280 – 311 (80-88%)</td>
</tr>
<tr>
<td>C+</td>
<td>273 – 279 (78-79%)</td>
</tr>
<tr>
<td>C</td>
<td>245 – 272 (70-77%)</td>
</tr>
<tr>
<td>D+</td>
<td>238 – 244 (68-69%)</td>
</tr>
<tr>
<td>D</td>
<td>210 – 237 (60-67%)</td>
</tr>
<tr>
<td>F</td>
<td>0 – 209 (0-59%)</td>
</tr>
</tbody>
</table>

Exam Note Sheet:
You are allowed to bring in one 8 1/2 X 11 note sheet into each exam. You may write anything that helps you for the exam on one side of this note sheet. You may not attach anything else to this page. The purpose of this sheet is for you to have access to the many formulas that we will encounter without having to memorize all of them. This note sheet will be turned in with each of your exams. If you violate any of these rules, you will receive a zero for that exam.
Some Important Administrative Issues

Class Attendance and Punctuality:
Part of your grade will be determined by your classroom participation, which requires that you attend class and be engaged with the course content while in class. Please note that arriving late to class is problematic and will lower your participation grade. I also occasionally give out a quick in-class assignment at the beginning of class and at other times during class. Make-up assignments will not be available for those who arrived late for beginning of class assignments or who were absent.

Cell Phones:
Please turn off your cell phone prior to class. As you know, ringing cell phones are a distraction to the rest of the class.

Computer Usage during Class:
You will not need your computers during my class, so please turn them off. Web surfing, answering emails, computer card games… are a distraction both for you and your peers. If you use your computer to take notes, please see me.

Make-up Examinations and Late Assignments:
Please note that late assignments will not be accepted. Make-up exams will be offered only under extremely extenuating circumstances and only if the student notifies me well in advance of the conflict. Students who miss an exam without satisfying the above two criteria will receive a zero for that exam.

Other Miscellaneous University Issues:
1. Document Retention Policy:
Student course material will be retained for three weeks beyond the end of the term.

2. Accommodations for students with disabilities:
"Students requesting classroom accommodation must first register with the Dean of Students Office. The Dean of Students Office will provide documentation to the student who must then provide this documentation to the Instructor when requesting accommodation."

3. The University’s honesty policy regarding cheating and use of copyrighted materials:
All students are required to abide by the Academic Honesty Guidelines set forth in the University of Florida Rules - 6C1-4 Student Affairs, 6Cl-4.0l7 Student Affairs: Academic Honesty Guidelines. The following website contains details covering the academic honesty guidelines: http://www.aa.ufl.edu/Handbook/students.html.
Regrade Policy:

To insure that all students are treated equally and fairly in the grading process, each student must follow the regrade policy below if they want their grade reconsidered. Please note that for me to reconsider your grade, you must provide me with the following material within 2-weeks of when the assignment was returned (within 2-weeks of the end of the term for the second course exam).

If you believe that your course points were **incorrectly summed**, please do the following:
1. Turn in *all* of your graded course material with corresponding points.
2. Clearly show me in writing where you believe the summation error occurred.
3. Provide me with your contact information – where I can reach you once I have evaluated your case (phone and email).

If you believe that you received **incorrect credit** for a particular portion of your graded material, please do the following:
1. Turn in *all* of your graded course material with corresponding points.
2. Provide me with a clear, type-written case (along with *very strong* supporting documentation) that clearly shows me why you believe that you received insufficient credit. Please note that you only have *1 opportunity* to make your case – so make it as clear and strong as possible. Also, please note that non-sense cases can result in your course grade being downgraded once all of your graded course material has been re-evaluated.
3. Provide me with your contact information – where I can reach you once I have evaluated your case (phone and email).
Brief Course Outline

Part 1: Introduction to Debt and Money Markets
Part 2: Interest Rates
Part 3: Bond Valuation
Part 4: Managing Bond Risk
Part 5: Bonds with Embedded Options

Exam Dates

Exam #1: Parts 1-3  February 26\textsuperscript{th}; during your scheduled class period
Exam #2: Parts 4-5  April 22\textsuperscript{nd}; during your scheduled class period
Detailed Course Outline

Part 1: Introduction to Debt and Money Markets

**Lecture 1**
Overview of Financial Assets and Capital Markets
- Financial Assets
- Capital Markets
  - Debt versus Equity Markets
  - Debt versus Money Markets
  - Purpose of Capital Markets

*Livingston: Introductory Chapter*

Taxonomy of Debt and Money Market Instruments (brief overview of security types)
- Some Distinguishable Features

*Livingston: Chapter 2, Chapter 5 (pgs. 80-88)*

**Lecture 2**
Security Market Microstructure
- Primary Market versus Secondary Market
  - Primary Market Debt Issuing Procedures
  - Secondary Market Structure

*Livingston: Chapter 3, Chapter 2 (pgs. 17-23)*
Part 2: Interest Rates

**Lectures 3-5**
Interest Rate Concepts
- Time Value
  - Future Value
  - Present Value
- Yields
- Interest Rates versus Returns

*Livingston: Chapter 4, 5 (pgs. 88-94)*

Real versus Nominal Interest Rates
- Inflation
- The Fisher Equation

*Livingston: Chapter 1 (pgs. 13-16)*

**Lectures 6-7**
Interest Rate Determination
- Intertemporal Consumption/Savings and Investment Decisions
- Loanable Funds Model
- Other Models

*Livingston: Chapter 1 and Packet - Chapters 2-3 from Money and Capital Markets*

**Lectures 8-9**
Term Structure of Interest Rates
- Some Background
- Deriving the Term Structure of Interest Rates
- Theories and Empirical Evidence
  - Pure Expectations Theory
  - Liquidity Theory
  - Preferred Habitat Theory
  - Market Segmentation Theory
- Interpreting Yield Curves

*Livingston: Chapters 7, 9*
Part 3: Bond Valuation

**Lectures 10-11**

Review
- Bond Prices
- Yields

Bond Price Theorems

Factors Influencing Bond Prices

*Livingston: Review Chapters 4, 5, 7*

**Exam #1: Parts 1-3**

Part 4: Managing Bond Risk

**Lectures 12-18**

Determinants of Bond Risk
- Reinvestment Rate Risk
- Price Risk
- Default Risk
- Call Risk
- Inflation and Yields
- Taxes and Yields

Reinvestment Rate Risk and Price Risk
- Interest Rate Risk
- Duration
- Convexity
- Immunization
- Interest Rate Futures, Options and Swaps
- Other Specialized Financial Instruments (financial engineering)

*Livingston: Chapters 6, 14, 15, [11 & 16 (options will be covered thoroughly in Part 5)]*
Lecture 19

Default Risk
- Financial Distress
- Bond Ratings
- Risk Structure of Interest Rates
  - Yield Spreads and Default Premia

Livingston: Review Chapter 10

Call Risk
- Introduction to Bonds with Embedded Options (covered in Part 5)
  - Characteristics and Purpose of Callable Bonds

Livingston: Packet – parts of Chapter 14 from Money and Capital Markets
(Callable Bonds will be covered thoroughly in Part 5)

Inflation
- Inflation and Yields

Livingston: Review Chapter 1 (pgs. 13-16)

Taxes
- Tax Treatment of Bonds
- Taxes and Yields

Livingston: Chapter 2 (pgs. 27-32)
Part 5: Bonds with Embedded Options

Lecture 20

Options
- Introduction and Definitions
- Valuation
- Factors
- Black-Scholes Option Pricing Model

Livingston: Chapter 11

Convertible Bonds

Livingston: Chapter 16 (pgs. 272-275)

Callable Bonds and Sinking Funds

Livingston: Chapter 12 (pgs. 201-204)

Lecture 21

Mortgage Backed Securities

Livingston: Chapter 13

Exam #2: Parts 4-5