Money and Investment

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Course Objectives:
To provide students with an understanding of the fundamental nature of money and credit (and therefore banking) and the basic principles of investment in financial assets. The course will also provide a brief overview of how innovation is affecting money, banking and investment.
The course will be divided into two main parts:

- First, it will seek to clarify the nature of money and the role played by both central banks and commercial banks in the money creation process. It will pay special attention to understanding this process from a balance-sheet perspective. It should thus shed light on recent controversies in monetary policy, such as quantitative easing, the huge expansion in central bank balance sheets, and exceptionally low interest rates. It will also seek to provide students with the knowledge to better assess the connections between monetary policy and the real economy, inflation and deflation, and the value of financial assets.

- Second, the course will provide an overview of investment in the main financial alternatives to money, namely stocks and bonds (and derivatives thereof), and explore the main principles of portfolio construction. This part of the course will have a practical focus, with students required to simulate investment portfolios online and present investment strategies to the class. It will review the main elements and conclusions of modern portfolio theory – the definition and measurement of risk, the risk-return trade-off and the historical record, the efficient frontier and optimal portfolio, the efficient market hypothesis and a comparison of passive and active investing. The main aim will be to familiarise students with both the language and fundamental principles of investment.

Methodology:
The course will combine lectures with discussion- and projected-based learning. I will distribute lecture notes and readings each week. There will be no required textbook.
The readings will include articles from financial newspapers, magazines or online media, including relevant blogs of interest. Students should be ready to discuss in class the issues raised in these articles.
We shall also create working groups to design an investment strategy and build virtual investment portfolios, thereby providing students with an opportunity to get some hands-on experience with investment decision-making, implementation and outcomes.

Readings:
<u>Background reading and reference textbooks:</u>

- Walter Bagehot, *Lombard Street: A Description of the Money Market* (1873, several publishers)

- Perry Mehrling, *The New Lombard Street: How the Fed became the Dealer of Last Resort*, Princeton University Press
- Peter L Bernstein, *A Primer on Money, Banking and Gold*, John Wiley & Sons
- Anata Admati and Martin Hellwig, *The Bankers' New Clothes: What's Wrong with Banking and What to Do about it*, Princeton University Press
- Zvi Bodie, Alex Kane and Alan J. Marcus, *Essentials of Investments*, McGraw-Hill.
- Keith Pilbeam, *Finance and Financial Markets*, Palgrave Macmillan.
- John Bogle, *The Little Book of Common Sense Investing*, John Wiley & Sons
- Jeremy J. Siegel, *Stocks for the Long Run*, McGraw-Hill

Other sources:
Online news/opinions/blogs:

www.marketwatch.com

http://finance.yahoo.com/ or https://www.google.com/finance

http://blogs.ft.com/ft-long-short/

http://www.economist.com/blogs/buttonwood

Evaluation:

Attendance & participation	10%
Mid-term exam	30%
Final exam	30%
Project work – investment strategy and simulation	30%

Draft agenda:
Part I: money and banking

- Overview and history of money
- Overview and history of inflation/deflation
- Linking money and inflation/deflation
- Banks and the fractional reserve system
- Liquidity, solvency, capital/equity
- Banking crises, regulation and the central bank as lender of last resort
- The determination of interest rates. Liquidity traps and the zero lower bound
- Central banks, balance sheets and quantitative easing

Part II: financial markets and investment

- Types of financial securities: money market instruments, bonds, equities, derivatives
- How to invest: financial markets, brokers, trading costs, pension funds, mutual funds, hedge funds, ETFs.
- Risk and return: probability distributions, variance and the historical record
- Risky and risk-free portfolios, the capital allocation line, correlations and diversification, the efficient frontier and the optimal risky portfolio
- Idiosyncratic and systematic risk: beta as a measure of risk and the CAPM
- The efficient market hypothesis and stock market prediction