Course Description

The course is organized around 4 modules:

1. Exchange Rates: Relationships and Institutions (≈ 7 sessions—1.5 hours each)
2. International Financial Instruments (6)
3. International Corporate Finance (7)
4. International Portfolio Management (8)

The broad coverage makes it relevant to a wide range of professional interests (e.g., corporate finance, global portfolio management, and corporate treasury management). The main objective is to enable students to work effectively in the context of international financial uncertainty. International financial events are both pervasive and important. Firms and investors cannot afford to neglect them. Those with expertise find it an enduring source of advantage.

The course prerequisite is BA 201B, or the equivalent (i.e., pass the waiver or make the case successfully to me). Finance background beyond BA 203 will be helpful, though not required.

Requirements

There will be four problem sets (25% of grade), an applied project (35%), and a final (40%). I encourage working together on the problem sets (3 per group maximum, hand in only one copy per group). Be forewarned of the stiff penalties for late problem sets: from a possible 10 points, four will be deducted for problem sets up to one lecture late; those more than one lecture late will not be accepted. The following page describes the applied project.

Readings

The required text is available at the bookstore: Multinational Financial Management by Alan Shapiro, New York: Wiley, sixth edition, 1999 (Denoted “MFM” below). A reader with additional articles is currently available and is required. There are two texts that will be helpful for backup reading, but are not required: (1) International Investments by Solnik, fourth edition (Addison-Wesley, 1999); and (2) International Economics by Krugman and Obstfeld, fifth edition (Addison-Wesley, 2000). Also, I expect you to keep abreast of international topics; I strongly recommend a student's subscription to either The Economist or the Financial Times.
The Applied Project

Description
The applied project is an opportunity to tailor the course to specific interests. You may work in groups from one to three people. The paper should be tightly focused, and roughly two thousand words of text irrespective of number of authors (about 8 pages, not including tables, figures, etc.). A one-page tentative proposal is due on Tuesday, February 26. The final draft is due in class on Tuesday, April 30. In addition to the written document, a few pairs will have an opportunity to brief the class on their projects in the last two weeks of the semester (=10 minutes per briefing). Being a member of this select group can only help your grade.

Acceptable Topics
You have considerable leeway in selecting a topic, as long as it involves international finance. Past topics have generally fallen into three broad categories: (1) International Financial Institutions and Instruments, (2) Managing Corporate Currency Risk, and (3) International Portfolio Investment. Three representative titles appear below, one from each category:

• Searching for the Best Exchange Rate Mechanism: The Argentine Case.
• Currency Hedging by a Japanese Multinational: NEC Corporation.
• Mexican Bonds: To Buy or Not To Buy? How do I Evaluate the Question?

Depending on your topic, you should consider your audience to be the head of research at an investment bank or the CFO of a corporation. Imagine that this person has charged you with addressing a particular issue on her mind. Your paper is your best effort to do so. It should be short, tightly constructed, and as prescriptive as possible.

Strategies For Topic Selection
• Scan issues of Euromoney and the Journal of Portfolio Management for topics.
• Scan The Economist, the Financial Times, or the WSJ for recent inspiring events.
• If you have contacts at a firm that operates internationally, you'll have an advantage on topics in the area of Managing Corporate Currency Risk.

Good Sources
• Datastream is an extremely rich source of international financial data (currencies, stocks, bonds, macro statistics, etc.). This is available on-line in the Computer Center and in Long Library.
• International Financial Statistics, published monthly by The International Monetary Fund, contains much financial and macroeconomic data for IMF member countries.
• The Economist's Intelligence Unit publishes quarterly Country Reports and annual Country Profiles. These are good, for example, for details on countries' foreign exchange regimes.
• Commercial and investment banks: most produce valuable research on current developments (e.g., Bank of America's monthly Currency Review).
• Euromoney is a periodical that focuses on issues relevant to this class; occasionally, a particular topic will be treated in depth in a Euromoney Supplement.
• The National Bureau of Economic Research (NBER) produces a working paper series that contains current academic articles on international topics (check http://www.nber.org).
• See my web page for links to useful sites in international finance (www.haas.berkeley.edu/~lyons).
Topic Scan

Module 1: Exchange Rates: Relationships and Institutions

- Models of exchange rate determination.
- Key international financial relationships.
- Exchange rate forecasting.
- Fixed versus floating exchange rates.
- FX market microstructure

Module 2: International Financial Instruments

- Currency swaps and their use.
- Currency futures.
- Currency options.
- Uses and abuses of currency derivatives

Module 3: International Corporate Finance

- Distinguishing different types of currency exposure.
- Determining which types to hedge and to what degree.
- International accounting diversity.
- International tax management.
- Cases on hedging various exposures.

Module 4: International Portfolio Management

- The benefits of international diversification.
- Global asset allocation: equities, bonds, and currencies.
- Currency hedging foreign stocks and bonds.
- The forecasting of excess returns.
- Emerging equity markets.
Schedule

Module 1: Exchange Rates: Relationships and Institutions

Jan. 22 (1): Course Overview
Reading: • None.

Jan. 24 (2): International Economic Linkages and the Balance of Payments
Reading: • MFM Chapter 4.

Jan. 29 (3): The Asset Approach to Exchange Rates (1)
Reading: • “Currency Forecasting: Theory and Practice,” M. Rosenberg.

Jan. 31 (4): The Asset Approach to Exchange Rates (2)
Reading: • MFM Chapter 2.

Feb. 5 (5): Key International Financial Relationships
Reading: • MFM Chapter 7, Chapter 5 pages 157-167.

Feb. 7 (6): Empirical Results: Forward Bias
    • “Is Currency Trading Profitable?” P. Green.

Feb. 12 (7): FX Markets (1): Players and Institutions
Reading: • “Overview of the Microstructure Approach,” R. Lyons.

Feb. 14 (8): FX Markets (2): Prices and Order Flow Analysis
Reading: • “Macro Puzzles: The Challenge for Microstructure,” R. Lyons.

Module 2: International Financial Instruments

Feb. 19 (9): Currency Forwards and Futures
Reading: • MFM Chapter 6, pages 172-178, 199-202.

Feb. 21 (10): Currency Options
Reading: • MFM Chapter 6, pages 178-199.
    • “Uses and Abuses of Currency Options,” G. Dufey and I. Giddy.

Feb. 26 (11): Currency Swaps (1)
Reading: • “Currency Swaps,” T. O'Brien.

Feb. 28: No Class

Mar. 5 (12): Currency Swaps (2)
Reading: • “Currency Swaps,” J. Evans.

Mar. 7 (13): Case: Using Currency Swaps
Reading: • “R.J. Reynolds International Financing,” HBS.
Module 3: International Corporate Finance

Mar. 12 (14): Accounting Exposure: Measurement
Reading: • MFM Chapter 8.
  • “Foreign Currency Transactions and Translation,” T. Harris.

Reading: • MFM Chapter 9.
  • “International Accounting Diversity,” F. Choi and R. Levich.

Mar. 19 (16): Economic Exposure: Measurement
Reading: • MFM Chapter 10.

Mar. 21 (17): Economic Exposure: Management
Reading: • MFM Chapter 11.

Apr. 2 (18): Case: Transaction Exposure Management
Reading: • “Dozier Industries.”

Apr. 4 (19): Managing a Multinational Financial System
Reading: • MFM Chapter 14.
  • “Corporate Risk Management,” The Economist, survey.

Apr. 9 (20): Case: Operating Exposure Management
Reading: • “Jaguar plc”.

Module 4: International Portfolio Management

Apr. 11 (21): Portfolio Currency Risk: Should it be Hedged?
  • “Risk Budgeting and the Currency Hedge,” Goldman Sachs.

Apr. 16 (22): Global Asset Allocation (1)
Reading: • MFM Chapter 19.

Apr. 18 (23): Global Asset Allocation (2)
Reading: • “Asset Allocation With Hedged and Unhedged Foreign Stocks and Bonds,” P. Jorion.
  • “Stocks and Currencies,” The Economist.

Apr. 23 (24): Global Asset Allocation (3)
  • “Lessons for International Asset Allocation,” P. Odier and B. Solnik.

Apr. 25 (25): Case: Global Equity Markets
Reading: • “Global Equity Markets: The Case of Royal Dutch and Shell,” HBS.

Apr. 30 (26): Emerging Markets (1)
May 2 (27): Emerging Markets (2)
Reading: • “Special FX,” G. Cooper.
  • “Top Secret Special FX,” N. Reed.

May 7 (28): Practitioner Visit and Project Briefings
Reading: • None.

May 9 (29): Review and Project Briefings
Reading: • None.

May 14 (30): Wrap Up
Reading: • None.
International Finance: Reading Packet Contents

1. “Questions on Readings,” Professor R. Lyons.


20. “Stocks and Currencies,” The Economist, 6/6/92, 87, Economist Newspaper LTD.


