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Spring Semester 2006

B9311-13 Ph.D. Seminar in International Finance

Course Outline and Reading List

Books:

Hodrick, Robert J. and Geert Bekaert, (H&B) *International Financial Management*, drafts of chapters from a forthcoming book to be published by Prentice Hall, 2006.

Hodrick, Robert J. *The Empirical Evidence on the Efficiency of Forward and Futures Foreign Exchange Markets*, Harwood Academic Publishers, New York, 1987.

Papers:

Copies of journal articles and working papers indicated with an asterisk (*) will be made available in class.

January 24, Class 1: Foreign Exchange Markets and Interest Rate Parity

*H&B Chapters 2-6

*Hodrick, Robert J., *The Empirical Evidence*, 1-27.

January 31, Class 2: Purchasing Power Parity and Real Exchange Rates

*H&B Chapters 8-10

Chen, L. L., and J. Devereux, 2003, "What Can US City Price Data Tell Us about Purchasing Power Parity? *Journal of International Money and Finance* 22, 213-238.

Parsley, David and Shang-Jin Wei, 2003, "A Prism into the PPP Puzzles: The Micro-Foundations of Big Mac Real Exchange Rates," NBER Working Paper No. 10074.

February 7, Class 3: Speculation and the Forward Market: The Unbiasedness Hypothesis

*H&B Chapter 7

*Hodrick, Robert J., *The Empirical Evidence*, 27-84.

Bekaert, Geert and Robert J. Hodrick, "On Biases in the Measurement of Foreign Exchange Risk Premiums," *Journal of International Money and Finance* 12, April 1993, 115-138.

Cornell, Bradford, "The Impact of Data Errors on Measurement of the Foreign Exchange Risk Premium," *Journal of International Money and Finance* 8, March 1989, 147-157.

Bossaerts, Peter and Pierre Hillion, "Market Microstructure Effects of Government Intervention in the Foreign Exchange Market," *Review of Financial Studies* 4, No. 3, 1991: 513-541.

Mark, Nelson and Young-Kyu Moh, "Official Intervention and Occasional Violations of Uncovered Interest Rate Parity in the Dollar-DM Market," NBER Working Paper No. 9948, August 2003.

Sercu, P. and M Vandebroek, 2005, "What UIP Tests on Extreme Samples Reveal about the Missing Variable," *Journal of International Money and Finance* 24, 8, 1237-1260.

February 14, Class 4: Small Sample Problems in the Rejection of Unbiasedness

*Bekaert, Geert and Robert J. Hodrick, "Expectations Hypotheses Tests," *Journal of Finance* 56, (August 2001): 1357-1394.

February 21, Class 5: Testing for Time Varying Risk Premiums

*Hodrick, Robert J., *The Empirical Evidence*, 84-138.

*Bekaert, Geert, "The Time-Variation of Expected Returns and Volatility in the Foreign Exchange Markets," *Journal of Business and Economic Statistics* 13, October 1995, 397-408.

*Engel, Charles, "The Forward Discount Anomaly and the Risk Premium: A Survey of Recent Evidence," *Journal of Empirical Finance* 3, (1996), 123-192.

Mark, Nelson C., "Time Varying Betas and Risk Premia in the Pricing of Forward Foreign Exchange Contracts," *Journal of Financial Economics* 22, (December 1988): 335-354.

Kaminsky, Graciela and Rodrigo Peruga, 1990, "Can a Time-Varying Risk Premium Explain Excess Returns in the Forward Market for Foreign Exchange," *Journal of International Economics* 28, 47-70.

Cumby, Robert E., "Is It Risk? Explaining Deviations from Uncovered Interest Parity," *Journal of Monetary Economics* 22, (September 1988): 279-299.

Giovannini, Alberto and Philippe Jorion, "The Time-Variation of Risk and Return in the Foreign Exchange and Stock Markets," *Journal of Finance* 44, (June 1989): 307-326.

Wheatley, Simon, "A Critique of Latent Variable Tests of Asset Pricing Models," *Journal of Financial Economics* 23, No. 2 (August 1989): 325-338.

Baillie, Richard and Tim Bollerslev, "A Multivariate Generalized ARCH Approach to Modeling Risk Premia in Forward Foreign Exchange Markets," *Journal of International Money and Finance* 9, September 1990, 309-324.

Lewis, Karen K., "Should the Holding Period Matter for the Intertemporal CAPM?" *Journal of Monetary Economics* 28, (December 1991), 365-389.

February 28, Class 6: Long-Horizon Predictability

*Hodrick, Robert J., 1992, "Dividend Yields and Expected Stock Returns: Alternative Procedures for Inference and Measurement," *Review of Financial Studies* 5, 357-386.

*Bekaert, Geert and Robert J. Hodrick, 1992, "Characterizing Predictable Components in Excess Returns on Equity and Foreign Exchange Markets," *Journal of Finance* 47, 467-509.

*Boudoukh, Jacob, Matthew Richardson, and Robert Whitelaw, 2005, "The Information in Long-Maturity Forward Rates: Implications for Exchange Rates and the Forward Premium Anomaly," NYU Stern Working Paper.

Boudoukh, Jacob, Roni Michaely, Matthew Richardson, and Michael R. Roberts, 2003, "On the Importance of Measuring Payout Yield: Implications for Asset Pricing," NYU Working Paper, December.

March 14, Class 7: Affine Models of Currency Pricing

*Dong, Sen, 2005, "Taylor Rules and Exchange Rates: A Structural VAR Identified with No Arbitrage," Columbia Business School working paper.

Backus, David, Silverio Foresi, and Chris Telmer, 2001, "Affine Models of Currency Pricing" *Journal of Finance* 56, 279-304.

Bansal, Ravi, 1997, "An Exploration of the Forward Premium Puzzle in Currency Markets," *Review of Financial Studies* 10, 369-403..

Brandt, Michael W. and Pedro Santa-Clara, 2001, "Simulated Likelihood Estimation of Diffusions with an Application to Exchange Rate Dynamics in Incomplete Markets" *Journal of Financial Economics*.

Brandt, Michael W., John H. Cochrane, and Pedro Santa-Clara, 2001, "International Risk Sharing Is Better Than Think," NBER Working Paper No. 8404.

Iwata, Shigeru and Shu Wu, 2005, "What International Risks Are (Not) Shared by International Investors," *Journal of Money, Credit and Banking* 37, 6, 1121-1141

Clarida, Richard H. and Mark P. Taylor, "The Term Structure of Forward Exchange Premia and the Forecastability of Spot Exchange Rates: Correcting the Errors" *Review of Economics and Statistics* 1997.

Dai, Qiang and Kenneth J. Singleton, 2000, "Specification Analysis of Affine Term Structure Models," *Journal of Finance* 55, no. 5, 1943-78.

Dai, Qiang and Kenneth J. Singleton, 2002, "Expectation Puzzles, Time-Varying Risk Premia, and Affine Models of the Term Structure," *Journal of Financial Economics* 63, 415-41.

Dai, Qiang and Kenneth J. Singleton, 2003, "Term Structure Dynamics in Theory and Reality" *Review of Financial Studies* 16, 631-78.

Bakshi, Gurdip and Zhiwu Chen, 1997, "Equilibrium Valuation of Foreign Exchange Claims" *Journal of Finance* 52, 799-826.

Saa-Requejo, Jesus, "The Dynamics of the Term Structure of Risk Premia in Foreign Exchange Markets," manuscript, University of Chicago, 1995.

Frachot, Antoine, "A Reexamination of the Uncovered Interest Rate Parity Hypothesis," *Journal of International Money and Finance* 15, (June 1996), 419-437.

Ahn, Dong-Hyun, 2004, "Common Factors and Local Factors: Implications for Term Structures and Exhange Rates," *Journal of Financial and Quantitative Analysis* 39, 1, 69-102.

Han, Bing, and Peter Hammond, 2003, "Affine Models of the Joint Dynamics of Exchange Rates and Interest Rates," Working Paper, University of Calgary.

March 21, Class 8: Equity Risk Premiums and the International Cost of Capital

*H&B Chapters 12-14

*Fama, Eugene and Kenneth French, "Value versus Growth: The International Evidence," *Journal of Finance* 53, December 1998, 1975-1999.

*Hodrick, Robert J., David Ng, and Paul Sengmueller, 1999, "An International Dynamic Asset Pricing Model," *International Tax and Public Finance* 6, November, 597-620.

*Karolyi, G. Andrew and René M. Stulz, 2003, "Are Financial Assets Priced Locally or Globally?" Chapter 16 in George Constantinides, Milton Harris, and René Stulz, eds., *Handbook of the Economics of Finance*, Elsevier: Amsterdam, The Netherlands.

Griffin, John M., Xiuqing Ji, and J. Spencer Martin, 2003, "Momentum Investing and Business Cycle Risk: Evidence from Pole to Pole," *Journal of Finance* 58, 2515-2547.

Froot, Kenneth A. and Paul G. J. O'Connell, 2003, "The Risk Tolerance of International Investors," NBER Working Paper No. 10157, December.

Claus, James and Jacob Thomas, 2001, "Equity Premia as Low as Three Percent? Evidence from Analysts' Earnings Forecasts for Domestic and International Stock Markets," *Journal of Finance* 56, 1629 – 1666

Stulz, René M., "International Portfolio Choice and Asset Pricing: An Integrative Survey," in *Handbooks of Operations Research and Management Science, Vol. 9, Finance*, edited by R. Jarrow, V. Maksimovic, and W. Ziemba, 1995.

Stulz, René M., "A Model of International Asset Pricing," *Journal of Financial Economics* 9, (1981): 383-406.

Adler, Michael and Bernard Dumas, “International Portfolio Choice and Corporation Finance: A Synthesis” *Journal of Finance* 38, (1983), 925-984.

Vassalou, Maria, "Exchange Rate and Foreign Inflation Risk Premiums in Global Equity Returns," *Journal of International Money and Finance*, 2000, 19, 433-470.

Jagannathan, Ravi and Zhenyu Wang, “The Conditional CAPM and the Cross-Section of Expected Returns,” *Journal of Finance* 51, March 1996, 3-53.

Fama, Eugene and Kenneth French, “Multifactor Explanations of Asset Pricing Anomalies,” *Journal of Finance* 51, March 1996, 55-84.

March 28, Class 9: International Capital Budgeting

*H&B Chapters 16-18

*Bodnar, Gordon M., Bernard Dumas, and Richard C. Marston, 2003, “Cross-Border Valuation: The International Cost of Equity Capital,” NBER Working Paper No. 10115.

Lee, Charles, David Ng, and Bhaskaran Swaminathan, 2003, “The Cross-Section of International Cost of Capital,” Cornell University manuscript, May.

April 14, Class 10: Models of Conditional International Equity Risk Premiums

*Harvey, Campbell, 1991, "The World Price of Covariance Risk," *Journal of Finance* 46, 111-158.

*Ferson, Wayne and Campbell Harvey, 1993, “The Risk and Predictability of International Equity Returns,” *Review of Financial Studies* 6, 527-567.

*Dumas, Bernard and Bruno Solnik, 1995, “The World Price of Foreign Exchange Risk,” *Journal of Finance* 50, 445-479.

*De Santis, Georgio, and Bruno Gerard, 1997, “International Asset Pricing and Portfolio Diversification with Time-Varying Risk,” *Journal of Finance* 52, 1881-1912.

*De Santis, Georgio, and Bruno Gerard, 1998, “How Big is the Premium for Currency Risk?” *Journal of Financial Economics* 49, 375-412.

Dumas, Bernard, Campbell R. Harvey, and Pierre Ruiz, 2003, “Are Correlations of Stock Returns Justified by Subsequent Changes in National Outputs?” *Journal of International Money and Finance* 22, 777-812.

Bansal, Ravi and Christian Lundblad, 2001, “Market Efficiency, Fundamental Values, and Asset Returns in Global Equity Markets,” manuscript.

Kasa, Kenneth, “Consumption-based versus Production-based Models of International Equity Markets,” *Journal of International Money and Finance* 16, October 1997, 653-680.

Chan, K.C., G. Andrew Karolyi and René Stulz, "Global Financial Markets and the Risk Premium on U.S. Equity," *Journal of Financial Economics* 32, 137-168.

Lin, Weng-Lin, Robert F. Engle, and Takatoshi Ito, “Do Bulls and Bears Move Across Borders?” *Review of Financial Studies* 7, 507-538.

Cumby, Robert E. "Consumption Risk and International Equity Returns: Some Empirical Evidence," *Journal of International Money and Finance* 9, June 1990, 182-192.

Korajczyk, Robert A. and Claude J. Viallet, "An Empirical Investigation of International Asset Pricing" *The Review of Financial Studies*, 2, 553-586.

Korajczyk, Robert A. and Claude J. Viallet, "Equity Risk Premia and the Pricing of Foreign Exchange Risk," *Journal of International Economics*, 1992.

Solnik, Bruno, "The Performance of International Strategies Using Conditioning Information," *Journal of Empirical Finance* 1, 33-56.

Cumby, Robert E. and Jack D. Glen, "Evaluating the Performance of International Mutual Funds," *Journal of Finance* 45, June 1990, 497-522.

April 11, Class 11: Sources of Gains from International Diversification

*“International Stock Return Comovements” with Geert Bekaert and Xiaoyan Zhang, NBER Working Paper No. 11906, December 2005.

Heston, Steve and Geert Rouwenhorst, 1994, “Does Industrial Structure Explain the Benefits of International Diversification,” *Journal of Financial Economics* 36, 3-27.

Griffin, John and G. Karolyi, 1998, “Another Look at the Role of the Industrial Structure of Markets for International Diversification Strategies,” *Journal of Financial Economics* 50, 351-373.

Ang, Andrew and Geert Bekaert, 2002, "International Asset Allocation with Regime Shifts,” *Review of Financial Studies* 15, 1137-1187.

Lewis, Karen, 1999, “Trying to Explain Home Bias in Equities and Consumption,” *Journal of Economic Literature* 37, 571-608.

Kang, Jun-Koo and René Stulz, 1997, “Why Is There Home Bias? An Analysis of Foreign Equity Ownership in Japan,” *Journal of Financial Economics* 46, 3-28.

Uppal, Raman, and Tan Wang, 2003, “Model Misspecification and Under-diversification,” *Journal of Finance* 58, 2465-2486.

April 18, Class 12: Exchange Rate Determination

*H&B Chapter 11

Mussa, Michael, 1984, “The Theory of Exchange Rate Determination,” in J.F.O. Bilson and R.C. Marston, eds., *Exchange Rate Theory and Practice*, Chicago, IL: The University of Chicago Press.

Chari, V.V., Patrick J. Kehoe, and Ellen R. McGrattan, 2002, “Can Sticky Price Models Generate Volatile and Persistent Real Exchange Rates,” *The Review of Economic Studies* 69, 533-563.

Additional Topics for Analysis

Assessing the Performance of Asset Pricing Models

Hodrick, Robert J. and Xiaoyan Zhang, 2001, “Evaluating the Specification Errors of Asset Pricing Models,” *Journal of Financial Economics* 62, 327-376.

Zhang, Xiaoyan, 2001, “Specification Tests of International Asset Pricing Models,” manuscript, Columbia University.

Emerging Markets

Forbes, Kristin, 2005, “The Microeconomic Evidence on Capital Controls: No Free Lunch,” NBER Working Paper No. 11372 May.

Bekaert, Geert, Campbell R. Harvey, and Chris Lundblad, 2005, "Growth Volatility and Equity Market Liberalization," *Journal of International Money and Finance*, forthcoming.

Bekaert, Geert and Campbell R. Harvey, 2003, "Emerging Markets Finance," Special Issue of the *Journal of Empirical Finance* 10, 1-217.

Bekaert, Geert and Campbell R. Harvey, 1995, “Time-varying World Market Integration,” *Journal of Finance* 50, 403-444.

Bekaert, Geert and Campbell R. Harvey, 1997, “Emerging Equity Market Volatility,” *Journal of Financial Economics*, 1997.

Bekaert, Geert and Michael S. Urias, 1996, “Diversification, Integration and Emerging Market Closed-End Funds,” *Journal of Finance* 51, 835-869.

Stulz, René and Walter Wasserfallen, “Foreign Equity Investment Restrictions and Shareholder Wealth Maximization,” *Review of Financial Studies* 6, (1995), 1019-1057

Li, Kai, Asani Sarkar, and Zhenyu Wang, 2003, “Diversification Benefits of Emerging Markets Subject to Portfolio Constraints,” *Journal of Empirical Finance* 10, 57-80.

Kumar, M., U. Moorthy, and W. Perraudin, 2003, “Predicting Emerging Market Currency Crashes,” *Journal of Empirical Finance* 10, 427-454.

Pricing Sovereign Risk

Duffie, Darrell, Lasse Pedersen, and Kenneth Singleton, 2003, “Modeling Credit Spreads on Sovereign Debt: A Case Study of Russian Bonds,” *Journal of Finance* 55, 119-159.

Pan, Jun and Kenneth Singleton, 2005, “Default and Recovery Implicit in the Term Structure of Sovereign CDS Spreads,” Stanford Business School, working paper.