

INTERNATIONAL FINANCIAL MANAGEMENT II: GLOBAL CAPITAL MARKETS FIN 614 – FALL 2021

Purpose:

Finance 612 & 614 are designed to familiarize students with the basic tools and concepts of International Financial Management. The main goal of this sequence is to provide the conceptual and analytical framework required for understanding how international financial conditions influence the decision-making process of modern business leaders in the corporate and capital markets arenas. Within Fin 612, we learned the major characteristics, institutions, and players of the exchange rate markets. We then considered the interaction between cross-border trade, capital flows, interest rates, inflation, monetary and fiscal policies, economic growth, and their impact on financial investment and corporate decision-making. Finally, we used these ideas to explore exchange rate regimes, Central Banks' intervention policies, and currency crises. Within Fin 614, we will examine various other international financial markets (equities, bonds, swaps, and other derivatives), and the opportunities they present for corporate financial policies, risk management, and portfolio management. We will also attempt to explain and interpret the recent wave of international financial crises affecting the global capital markets. This sequence is tailored to students seeking careers in international banking and portfolio management or in finance and strategy for domestic and multinational corporations. Due to the nature of the material, the course will be taught in the form of lectures using many of the quantitative tools you have learned in previous Finance, Economics, and Statistics courses.

Instructor:

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TA:	Emil Lakkis	Email:	elakkis@umich.edu

Office Hours:

Tuesdays: 2:00 p.m. to 4:00 p.m. remotely, by appointment, via Zoom at the following link:

https://umich.instructure.com/courses/383287/external_tools/27754

See the Canvas class website for the TA's remote office hours via Zoom.

Course Materials:

There is one required textbook for this course:

1. ***International Financial Management*** by Geert Bekaert and Robert Hodrick, 3rd edition (Cambridge University Press) [1st or 2nd editions are fine]; the Kresge library has a free digital edition available at the following link:

<http://proxy.lib.umich.edu/login?url=https://doi.org/10.1017/9781316282274>

I will provide specific additional readings and lecture notes on the Canvas class website.

Additional textbooks you may be interested in (but are NOT required) are:

2. ***International Investments*** by Bruno Solnik and Dennis McLeavey, 5th or most recent edition (Pearson Addison-Wesley).
3. ***International Financial Markets***, by Richard Levich (McGraw-Hill Irwin);
4. ***International Money and Finance***, by Michael Melvin (Pearson Addison-Wesley).

All of these additional textbooks are also available for consultation at the **Kresge Library**.

Please always check the Canvas class website at least a day prior to each class session: **YOU ARE RESPONSIBLE** for downloading all class materials, handouts, and readings for a session. The Canvas class website also contains a **discussion board**, where I will occasionally post messages with answers to frequently asked questions.

Homework:

Two homework problem sets will be assigned throughout the term. The homework will be posted on the Canvas class website. Due dates for the homework are indicated below.

Homework may be done individually or in groups. Nonetheless, homework assignments must be submitted **individually, on the Canvas class website (under Quizzes), prior to class-time on the due date**. Late homework will not be accepted.

Homework 1: Due at the beginning of LECTURE 7

Homework 2: Due at the beginning of LECTURE 11

Practice Quizzes:

Three **ungraded** practice quizzes (made of five questions each) will be available throughout the term. The quizzes will be posted on the Canvas class website (in the Modules section). Practice quizzes are for your self-assessment and **won't count toward your final grade; however, you are required to try each of them, at least once.** Afterwards, the quiz will show you how to work through the solution. **I suggest you to work on the questions on your own first, before looking at the solutions.** The quizzes provide additional practice for the final exam.

Group Project:

There will be one group project. The purpose of the project is to write a “**global asset allocation report.**” Asset allocation reports are routinely prepared and distributed by investment banks to clients worldwide. Typically, such a report is focused on a wide range of asset classes (stocks, bonds, cash, commodities, real estate) and countries (developed, emerging). The report includes an analysis of the world business cycle, as well as of relevant economic, financial, and political events taking place in selected markets and regions: Elections, Central Bank interventions, important monetary or fiscal decisions, etc. Finally, the report uses all this and other information to formulate **tactical** (short-term, e.g., up to 1 year) and **strategic** (long-term, e.g., up to 5 years) global asset allocation recommendations for investors with different degrees of risk aversion. You will also have to recommend whether and how the potential risk/return trade-off stemming from the foreign exchange exposure of the selected portfolio should be addressed.

Your team has to prepare and submit such report to me. **The report itself will have to be of no less than three but no more than four pages in length.** Indeed, global investors and CFOs tend to be busy and have little or no time for lengthy dissertations. Hence, your recommendations will have to be prominently placed in the report (for example, with the help of pie charts). Your analysis has to employ the tools and techniques we will discuss in

class (for instance, return forecasting), as well as any other economic, financial, or statistical tool you may be comfortable with. In addition, you **MUST** construct your portfolio allocation using the portfolio optimization techniques we will discuss in class. I will provide you with sample allocations you can use to ensure your portfolio engine is generating the correct numbers. **You do not have to use Excel to construct the portfolio engine. Yet, you will have to send me an email with any software code/program you used for the optimization together with the final report.**

Asset allocation reports are generally not too technical in nature, since they strive to be read by the largest possible number of clients. Therefore, you will attach an **Appendix of no less than two and no more than four pages in length** in which you describe the analytics and details of the methodologies you used to prepare the report. **Shorter or longer reports will be penalized.**

This project is to be completed in groups of three to five members. You have to submit only one report for the entire group, being careful to note all the names of group members, via email to me, in PDF format only, by 9:00 am of the due date: December 12, 2021. Late reports will not be accepted. The report will be graded based on quality of content, quality of exposition, and the extent to which it feels “professionally” executed.

I cannot stress this enough: Start planning and working on this project early, especially on the portfolio optimization engine ... few hours of work prior to the due date are insufficient to generate a “passing grade” report. **We will also devote some class time to discussion of the main issues you may encounter when working on your project.**

Data Collection: The Tozzi Center

As you will soon notice, one of the most challenging tasks for your project is to collect data. In the Files section of the Canvas class website, there is a subsection titled **International Finance Web Resources**; there you will find links to sources for most of your data needs.

In addition, you can look for the data you need in the Tozzi Center. Located in the first floor of the Executive Residence, the Tozzi Center is a state-of-the-art lab with PCs running the most important data applications in Finance (Reuters, Bloomberg, Datastream, etc.). **Kai Petainen** is the manager of the Tozzi Center and has kindly agreed to provide data retrieval help to the students of FIN 614. He has prepared a special folder with all the information you may need to collect data in the Tozzi Center, as well as with the most requested data series. He can also help you find any new data you may be looking for. The Tozzi Center is open all day long; Kai is usually available throughout the day, although he tells me that the best times for him to help you are usually in the mornings and in the late afternoons.

Final Exam:

The final exam will be a 2-hour remote, multiple-choice exam on:

December 14, 2021 from 4:00 pm to 6:00 pm, Zoom Classroom (video ON).

There will be no makeup exam, unless you miss the exam because of a well-documented, valid written medical excuse (e.g., a doctor's note stating that it would have been impossible for you to be on Zoom by the scheduled day/time). The exam will be available to you on the Canvas class page, under Quizzes. The exam will be closed-book. You are not allowed to use any material during the exam besides **one calculator, your PC/laptop/tablet to read the test and choose your answers, and one 8-1/2" x 11" sheet of paper with notes and formulas** (both sides are ok) **on it**. The **paper does not have to be handwritten** (yet, it cannot contain any of the slides from the lecture notes or any of the solution sheets from the homework) and **has to be uploaded on the Canvas exam page (a photo, front and back, is fine)** as soon as you complete your exam.

Grading Policy:

Class Participation / Attendance	10%
Homework	10%
Group Project	40%

Final Exam 40%

Class participation for one-way remote students will be assessed holistically, for example by rewarding contributions to the discussion board, among others.

I will grade graduate students according to the following grading policy set by the Ross School of Business for MBA electives, assigning (roughly):

“Excellent”	to ≤ 35% of the students
“Good” or “Excellent”	to ≤ 75% of the students
“Pass” or above	to 100% of the students.

Personal integrity and professionalism are fundamental values of the Ross Business School community. This course will be conducted in strict conformity with the **Academic Honor Code**. The Code and related procedures can be found at the following website: www.bus.umich.edu/Academics/Resources/communityvalues.htm. The site also contains comprehensive information on how to be sure that you have not plagiarized the work of others. Claimed ignorance of the Code and related information appearing on the site will be viewed as irrelevant should a violation take place. Non-Ross Business School students taking the course should also familiarize themselves with the Code as they will be subject to the Code as well while in this course.

Attendance & Lecture Notes Requirements for Final Exam:

Attendance to this course (either remotely or in-person) is mandatory. Lectures will stress the most important issues addressed in the course and may go beyond the scope of the textbook for certain topics. **You are responsible for announcements in class;** consult a colleague if you are absent. Perfect attendance will factor into grading for those on the edge of grade distributions. **If you choose to attend the live sessions, please place a name tag with your name in front of your seat at all times.**

In the final exam, you will be deemed responsible for all the material in the main portion of the lecture notes, even if I may not be able to cover in depth each slide due to

the shortened hybrid class format; the material in the [appendix to each set of lecture notes is instead optional and won't be required for the final exam.](#)

Health and Safety - COVID-19

For the safety of all students, faculty, and staff on campus, it is important for each of us to be mindful of safety measures that have been put in place for our protection. By returning to campus, you have acknowledged your responsibility for protecting the collective health of our community. **Your participation in courses on an in-person basis is conditional upon your adherence to all safety measures mandated by the State of Michigan and the University, including maintaining physical distancing of six feet from others, and properly wearing a face covering in class.** Other applicable safety measures may be described in the [Wolverine Culture of Care](#) and the [University's Face Covering Policy for COVID-19](#). **Your ability to participate in this course in-person as well as your grade may be impacted by failure to comply with campus safety measures.** Individuals seeking to request an accommodation related to the face covering requirement under the Americans with Disabilities Act should contact the [Office for Institutional Equity](#). **If you are unable or unwilling to adhere to these safety measures while in a face-to-face class setting, you will be required to participate on a remote basis (if available) or to disenroll from the class.** I also encourage you to review the [Statement of Students Rights and Responsibilities](#), which includes a COVID-related Statement Addendum.

Wellness and Mental Health

As a student, you may experience a range of issues that can cause barriers to learning, such as strained relationships, increased anxiety, alcohol/drug problems, feeling down, difficulty concentrating and/or lack of motivation. These mental health concerns or stressful events may lead to diminished academic performance or reduce a student's ability to participate in daily activities. University of Michigan is committed to advancing the mental health and wellbeing of its students. If you or someone you know is feeling overwhelmed, depressed, and/or in need of support, services are available. You can learn more about the broad range of confidential mental health services available on campus [here](#), including our campus' office

of [Counseling and Psychological Services](#) (“CAPS”). You may also find helpful the [well-being resources for students](#) offered through the University’s office of student life.

The Ross School of Business has a CAPS Embedded Counselor available to its students. Embedded Counselors are located in school/college buildings and services are tailored to the school’s climate. For more information, please visit the [CAPS Embedded Model](#) site. [caps.umich.edu/caps-embedded-model](#). To schedule, please email [Julie Kaplan](#), LMSW. Also, the services offered by CAPS have been adapted to the unique needs of our community during COVID. You can schedule a tele-health appointment remotely from their home page. You may also find helpful their resources directly addressing mental health and wellness during COVID [here](#). If you have an urgent matter when CAPS is closed, please call 734-764-8312 to connect with [CAPS After Hours](#).

Academic Integrity and Community Values

This discussion of academic honesty and conduct is not exhaustive, and there may be areas that remain unclear to you. If you are unsure whether some particular course of action is proper, it is your responsibility to consult with the faculty immediately for clarification.

Personal integrity and professionalism are fundamental values of the Ross School community. You have a duty to be familiar with and understand the Ross School’s Statement of Community Values, the Ross School Academic Honor Code, and the Ross School Code of Student Conduct including all campus public health policies. **In light of COVID our community has enhanced the Code of Student Conduct to include our commitment to each other and adherence to campus and School public health policies.** Each of these, including a Statement of Student Rights and Responsibilities, may be found in the Ross School Impact on [Ross Community Values](#). In addition every student at the University of Michigan accepts the rights and responsibilities of membership in the University’s academic and social community. These rights and responsibilities are clearly laid out in [The Statement](#). By enrolling in this course you confirm that you have read and understood these statements and policies, and further that you agree to abide by them. The Ross Community Values site contains valuable information and links on writing and how to

check to make sure you have not plagiarized the work of others. Claimed ignorance of these codes and policies will be viewed as invalid should a violation take place. In all cases if you have questions please address them with the professor as far **in advance** as possible. Any violation of the Ross School Academic Honor Code such as plagiarism, otherwise passing off anyone else's work as your own, unauthorized collaboration, use of materials generated for use during past offerings of this course, or any form of cheating will be referred to the Community Values Committee. Possible penalties include course failure with a permanent notation of an honor policy violation on your transcript and even expulsion. As a community we are all still adapting and learning how this applies to hybrid and remote learning environments, but the same principles of academic integrity apply.

Policy Related to the Use of Class Materials

All materials generated for the course including slides, handouts, review materials and assignments, or any other materials prepared by you or the professor for this course, are intended for use by current students in this class only, unless you have the permission of your instructor. You are not permitted to use materials related to the class that were generated by the professor or students in previous versions of this course. A violation of this policy may be a violation of the Ross Community Values Code and may result in disciplinary action.

Accommodations

The University of Michigan is committed to providing equal opportunity for participation in all programs, services and activities. Students wishing to receive testing accommodations must register with the University of Michigan [Services for Students with Disabilities \(SSD\)](#) office as soon as possible.

Students must then submit their accommodations requests two weeks prior to the first test or quiz for which they require accommodations. Accommodations arrangements are not guaranteed for students who provide less than two weeks' notice.

Students verified for accommodations through the SSD office prior to July 19, 2021 must submit their Verified Individualized Services and Accommodations (VISA) form to the Ross Accommodations Coordinator via online web form ([Ross Accommodations Request Form](#)). The submission must include a scanned or photographed copy of the VISA form. This form only needs to be submitted once during the academic career with Ross unless the accommodations eligibility expires.

Students verified for accommodations through the SSD office on or after July 19, 2021 must send their Accommodation Letter through the new Accommodate system at the start of each semester as early as possible. For Ross courses, these letters will come directly to the Ross Accommodations Coordinator. The day the Accommodation Letter is sent will be used to determine two weeks' notice.

In rare cases, the need for an accommodation arises after the two week deadline has passed (example: a broken wrist). In these cases, students should still contact SSD and the Ross Accommodations Coordinator. However, due to logistical constraints, we cannot guarantee that an accommodation can be made after the two week deadline has passed.

Questions can be directed to the Ross Accommodations Coordinator:

RossAccommodationsCoordinator@umich.edu

Laptop & Electronic Device Use and Zoom Connectivity in Class

Laptop and electronic device use will be necessary for learning for both in-person and remote courses. Naturally, for those attending courses remotely you will need an electronic device (e.g. desktop, laptop, tablet) with video camera (built in or external), audio device and a microphone to engage fully in the course. A stable and sufficient bandwidth connection will also be necessary.

All remote students are to have their camera on during class. Use of your laptop should be for learning and discussion in class with the class material. Please contact your faculty member if you encounter challenges with laptops/electronic devices/internet

connectivity/remote learning environment which may impede your ability to learn in the course.

Recordings

Faculty may choose to record some or all of the delivery of the course material. These recordings may be made available to other students in your assigned course section to support learning of those affected by illness or unforeseen circumstances. If you have questions about class recording policies, please contact the faculty the first week of class.

Students may not record or distribute any class activity without written permission from the instructor, except as necessary as part of approved accommodations for students with disabilities. This applies to both the live recording of an actual class, as well as the duplication of any recordings shared by the faculty with the course participants. Any approved recordings may only be used for the student's own private use.

In-Class Conduct

For those attending class in-person (hybrid and in-person courses):

- Observe **all** safety precautions and protocols, including **wearing of face coverings**.
- **Sit only at locations indicated by the blue dots and corresponding seat.** Please do not move your seating away from the blue-dot location as this would decrease social distancing and safety.
- Use your laptop to connect to the Zoom for the class. Keep your camera on for the duration of the class. Please contact your professor if you have any questions or concerns.

For those attending class remotely, you are expected to:

- Attend the class in its entirety via the dedicated Zoom platform provided for the course.
- Attend the class with your camera **on** and fully focus on the class just as if you were physically present in class. Keeping your camera on is required. Please contact your professor if you have any questions or concerns.

- Make eye contact with the camera - you are essentially looking into the eyes of each and every classmate, and the professor!
- Be present in appropriate attire that you would have worn to class.
- “Arrive” early to get everything prepared so you do not feel rushed and are able to be ready when class begins.
- Use your first and last names, along with preferred pronouns, in your zoom link.
- **Remember to mute your audio when not speaking, in order to minimize any unnecessary external noise.** This will become second nature to you as you become familiar with muting and unmuting your audio. You can mute/unmute your audio by clicking on the microphone (if using computer audio) or telephone (if using phone audio) in the lower left corner of your Zoom screen.
- **Perhaps most importantly, remember that you are not invisible, and your professor and classmates are depending on your visual cues, such as smiling and nodding, for encouragement.** Imagine how dull a conversation would be with someone who was expressionless and motionless.

Compliance with Health Protocols

The health and safety of our community is of paramount importance, and we must all do our part in keeping our community safe. This commitment is not only about keeping ourselves healthy and safe, but it is about keeping everyone in our community healthy and safe. We all must do our part in service to others. We must all embrace our shared responsibility to the Michigan Ross community. While on the Ross campus, if you see or experience something that concerns you, we encourage and support you to take the following actions:

- **Speak Up:** If you see someone not adhering to health and safety guidelines;
- **Remove Yourself:** If you are in a situation that puts your health or safety at risk;
- **Contact Supervisor/Area Chair:** Notify your supervisor or area chair of concerns;

- **Contact Your Program Office:** Notify your program office of concerns; U-M Compliance Hotline: Report concerns online at: compliance.umich.edu or call 866-990-0111.

If members of our community do not follow our public health requirements and policies, they will be addressed. Actions to address non-compliance generally will be rooted in a consideration of the circumstances and will be aimed at education and correction before escalating to sanctions or discipline, as appropriate. In particular, **failure to comply with the "mask-on" policy in the classroom may lead to you being asked to leave the classroom, the lecture being terminated early, and you losing all privileges to be on the Ross campus for classes, studying, or events.**

We all have a responsibility for ensuring the wellness of our whole community. Therefore, **I will not attend class if I am not feeling well. I will notify you as soon as possible if I cannot attend in person and I may provide alternative arrangements for the class session during the assigned class time.**

Remember that these rules are for your own safety as well as for the safety of others!

Course Content & Class Schedule (tentative):

1. The International Equity Markets

1.1. International Equity Markets and Instruments (LECTURES 1 & 2)

Opportunities for investors (diversification, return enhancement) and corporations (additional sources of financing) in international equity markets; global market size, liquidity and concentration; value of control for family-owned firms; historical differences in market organization and trading procedures; trading mechanisms in foreign equity markets (price-driven versus order-driven); tax aspects; market indexes; stock cross-holdings for corporations in Asia and Europe; execution costs; ADRs; benefits and costs of ADR holdings for investors; benefits and costs of ADR issuance for corporations (agency problems, signaling, currency for U.S. acquisitions, etc.); open end funds, closed end funds, exchange traded funds, country funds, regional funds.

Suggested readings: Bekaert-Hodrick (Chap. 12); Solnik (Chap. 5); Levich (Chap. 15); Melvin (Chap. 7)

1.2. International Equity Diversification (LECTURES 3 & 4)

The case for international diversification: Risk reduction through attractive correlations; portfolio return performance; currency risk not a barrier to international investment; the mathematics of diversification; the case against international diversification: Increases in correlations during bear markets; barriers to international investments; segmentation; globalization.

Suggested readings: Bekaert-Hodrick (Chap. 13); Solnik (Chap. 4); Levich (Chap. 15, Appendix to Chap. 14); Melvin (Chap. 7)

1.3. International Asset Pricing (LECTURES 5 & 6)

Building and using a portfolio engine: More on the mathematics of diversification; determining the inputs; a review of market efficiency and the domestic capital asset pricing

model (CAPM); asset returns and exchange rate movements; the domestic CAPM extended to the international context; international CAPM (ICAPM); the World CAPM; implications for corporations' cost of equity capital in financially integrated capital markets: The Nestle example; assessing the exposure of corporations' (cost of) equity capital to currency risk: Translation risk and business currency risk, the Novartis example.

Suggested readings: Bekaert-Hodrick (Chap. 13, 16.2); Solnik (Chap. 4); Levich (Chap. 15); Melvin (Chap. 7)

1.4. Issues in International Asset Pricing (LECTURE 7)

Alternatives to CAPM, ICAPM, and World CAPM: APT, Fama-French; integration versus segmentation; integration, segmentation, market efficiency, and pricing; further implications for corporations' risk and cost of capital of (time-varying) financial market integration; the case for and against investing in Emerging markets; risk and opportunities for corporations in Emerging markets; the impact of financial market integration for Emerging market firms (cost of capital, return volatility, net profits); home bias.

Suggested readings: Bekaert-Hodrick (Chap. 13); Solnik (Chap. 6, 9); Levich (Chap. 15); Melvin (Chap. 7)

2. The International Bond Markets

2.1. Global Bond Markets, Instruments, and Pricing (LECTURES 8 & 9)

The various segments; world market size; bond indexes; the Eurobond market; emerging markets and Brady bonds; types of instruments; quotations; global bond markets as additional sources of funding for corporations; costs and benefits of Eurobond markets versus local corporate bond markets as sources of capital for corporations; the Eurobond issuing process; refresher on bond valuation (zero-coupon bonds, bonds with coupons, duration and interest rate sensitivity, credit spreads and the determinants of credit risk); credit default swaps; international yield curve comparisons; sovereign default risk; the return and risk on foreign bond instruments; a multicurrency approach to bond investing; international diversification with bonds.

Suggested readings: Bekaert-Hodrick (Chap. 11, 14.3); Solnik (Chap. 7); Levich (Chap. 10, 14); Melvin (Chap. 13)

3. Global Asset and Liability Management

3.1. Issues in Global Portfolio Management (LECTURE 10)

International portfolio diversification: Active versus passive asset allocation; strategic versus tactical asset allocation; determining the inputs: Forecasting international asset returns; prediction regressions; local versus global variables in prediction regressions; time-varying volatility and correlations; sensitivity analysis; reasonable portfolio allocations: Weight constraints; tracking-error optimization; the Black-Litterman approach. In-class group project discussion and work.

Suggested readings: Solnik (Chap. 13, Appendix to Chap. 3); Levich (Chap. 14, 15)

3.2. Currency Risk Management (LECTURE 11)

Basics of currency forwards, futures, options; a crucial choice for investors and corporations: Hedging foreign exchange risk with currency forwards, futures, or option contracts; insuring and hedging with options; other methods for managing currency exposure; the BlackRock example of protective puts; currency overlay.

Suggested readings: Bekaert-Hodrick (Chap. 20); Solnik (Chap. 10, 11); Levich (Chap. 11, 12); Melvin (Chap. 4)

4. International Financial Crises (LECTURE 12)

Historical perspective on international financial crises; alternative definitions of financial crises; banking crises; currency crises; bubbles; twin crises; financial contagion; what causes financial crises and why they propagate across countries and markets; implications of financial crises for investors' portfolio choices and corporations' financing and capital budgeting decisions; corporations' cost of capital and currency crises.

Suggested readings: Bekaert-Hodrick (Chap. 10.5, 14.1, 14.3); Levich (Chap. 1, 2, 8);
Melvin (Chap. 13)