

**UNIVERSITY OF NOTRE DAME**  
**DEPARTMENT OF FINANCE**  
**FIN 70600–FINANCE II**

**Spring (Module 3) 2008**

**INSTRUCTOR:** Professor Rick Mendenhall  
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**OFFICE HOURS:** By appointment

**TEXT:** Custom text consisting of chapters 9, 10, 11, 13, 22, and 23 from *Corporate Finance* 8<sup>th</sup> ed. by Ross, Westerfield, and Jaffee.

**ADDITIONAL MATERIALS:** Various notes and readings handed out during semester and/or made available electronically.

**COURSE DESCRIPTION:**

We cover topics that I (and other members of the Finance Department) believe are important for all MBAs to understand. These topics include theory, empirical results, and institutional aspects of finance. Because this is a core course taken by all MBAs, the intention is to be broad as opposed to covering one or two topics in detail. If you are interested in learning more about a particular topic, however, I will be glad to assist you. We cover what my colleagues and I believe are some of the most important and powerful ideas in finance. For example, we cover three sets of ideas that each earned the Nobel Prize in economics for their authors. By understanding these principles, we believe that you will be better corporate or investment managers no matter what your area of specialization.

**GRADING:**

Your grade will be determined primarily by your performance on two exams. The intent of the second exam is to test the learning that has taken place since the first exam. Some of the principles and concepts of this course build on one another, however, and only to this extent is the second exam comprehensive. To aid you in studying the course material, I will make available some past exams from this course. These should give you an idea of test format and what types of questions I am likely to ask. You are allowed to bring one sheet of paper to each exam. *Anything* may be written, typed, drawn, or printed on either or both sides of the sheet.

In lieu of class projects, you will have an ongoing practical homework assignment to be handed in every week or so (discussed below). You will not lose points for making mistakes on the assignment. You will lose points if you fail to hand in an assignment on time or if it does not appear that you put forth reasonable effort. Since I expect everyone to hand in an acceptable assignment each time, they should not impact anyone's grade. Finally, at the margin, chronic absence may also hurt your grade, while constructive class participation may help it.

## GENERAL:

### Homework:

I intend to send you an email after each class. In that email I will normally list some end-of-chapter questions, and perhaps include some additional questions, that are relevant to the material we have covered. Generally, on Wednesdays only, I will give an assignment, which will normally include the practical homework assignment discussed above, that is due to be handed in on the subsequent Monday (five days later). I will make it very clear in the email whether or not a particular assignment is to be handed in. Assignments to be handed in may require you to obtain data from one or more financial web sites and to use Excel. You may do this work in self-selected groups of three or four students. If you have any trouble with any of the assigned questions/problems—whether or not they are to be handed in—you are encouraged to talk to me about them.

The email will also indicate whether there is a new reading assignment. Studies show that learning is enhanced when students' *first* exposure to material occurs outside the classroom. In other words, lectures mean more to students who already know something about what is to be discussed. So, you should read the assignments prior to class. The reading for this class is minimal, so there is no reason not to complete the assignments. You should also think about the assignment and whether it makes sense to you. Be an active reader and generate questions about the material and see if they are answered in class. If they are not, please raise them during class, or discuss them with me outside of class.

### Attendance Policy:

I do not take attendance but, as noted above, I may note *chronic* absence or lateness. In the face of poor class attendance, this policy is subject to change—please, do not let that happen. My expectation is that you will come to class and, at a minimum, participate mentally. **\*\*If you miss a class, it is your responsibility to contact another student to obtain any handouts and handwritten notes to determine what you have missed.\*\*** After you have discussed the class with another student and obtained their notes, you are encouraged to ask me specific questions about the material.

### Honor Code:

**The current Graduate Business Honor Code applies to this course.** If you have any questions about the honor code or any questions about what is allowed and what is not allowed in this course, please ask me.

## Finance II Course Plan

“Plans are useless, but planning is indispensable” –Dwight D. Eisenhower. In deference to President Eisenhower’s insight, we are *planning* to change the *plan* as necessary as the module progresses.

Class Number	Date	Topic	Reading Assignment
1	Monday, January 14	<b>Background:</b> Stock Indexes; Definition of returns; risk; Normal distribution; Measures of average returns; Intro to History of Returns.	RWJ: Ch. 9.
2	Wednesday, January 16	Finish <b>Background</b> . <b>Risk and Return (1):</b> Expected return, risk, correlation, and covariance; Introduction to risk-return space. Risk and return for two-investment portfolios.	RWJ: Ch. 10 Sections 1, 2, 3, and 4.
3	Monday, January 21	<b>Risk and Return (1):</b> Efficient set for many (more than two) securities; utility and indifference curves. Effects of diversification. Riskless borrowing and investing; the Capital Allocation (Market) Line; the Optimal Risky Portfolio.	RWJ: Ch. 10 Sections 5, 6, and 7.
4	Wednesday, January 23	<b>Risk and Return (2):</b> Factors that affect the required rate of return; who uses CAPM? The Market Portfolio; Relevant risk of an investment under CAPM; Beta; Relation between risk and return under CAPM.	RWJ: Ch. 10 Sections 8 and 9.
5	Monday, January 28	<b>Risk and Return(2):</b> Catch up; Wrap up of logic behind the CAPM. Tests of CAPM; Work some problems.	RWJ: Ch. 10 Section 9. Handout(s)?
6	Wednesday, January 30	<b>Estimating the Cost of Capital:</b> Applying CAPM in the real world. Estimating the Cost of equity capital: Estimating beta; Estimating $R_f$ ; Estimating the Equity Risk Premium.	RWJ: Ch. 12 Sections 1, 2, and 3. Dimson, Marsh, and Staunton article.
7	Monday, February 4	<b>Estimating the Cost of Capital:</b> Estimating the cost of debt; The term structure; Putting it all together to estimate the WACC.	RWJ: Ch. 12 Sections 4 and 5.
8	<b>Wednesday, February 6</b>	<b>First Exam (Covers sessions 1 through 6.)</b>	

<b>Class Number</b>	<b>Date</b>	<b>Topic</b>	<b>Reading Assignment</b>
<b>9</b>	Monday, February 11	<b>Go over first exam.</b> <b>Finish Estimating the Cost of Capital</b> if necessary. Applying the WACC to individual projects. <b>Market Efficiency:</b> Definitions; Implications of market efficiency; Three forms of market efficiency; Evidence supporting market efficiency; Anomalies;	RWJ: Ch. 13. Malkiel article
<b>10</b>	Wednesday, February 13	<b>Market Efficiency.</b> Continue with topics from Session 9.	RWJ: Ch. 13. Malkiel article
<b>11</b>	Monday, February 18	<b>Options Basics:</b> Definitions; terminology; Trading; Basic payoff and profit diagrams; Options quotes; Simple option combinations; Put-Call Parity.	RWJ: Ch. 22 Sections 1 through 6.
<b>12</b>	Wednesday, February 20	<b>Option Valuation:</b> Binomial model; Black-Scholes; Factors that affect option values; <b>Options and corporate finance:</b> Stocks and bonds as options; Mergers and diversification;	RWJ: Ch. 22 Sections 7 and 8.  RWJ: Ch. 22 Section 9, 10, 11.
<b>13</b>	Monday, February 25	Wrap up. Discuss more options and corporate finance if time permits.	Selected parts of RWJ: Ch. 23 if time permits.
<b>14</b>	<b>Thursday, February 28</b>	<b>Second Exam (Covers sessions 7 and 9 through 13.)</b>	