



MOORE SCHOOL OF BUSINESS  
UNIVERSITY OF SOUTH CAROLINA

**IBUS 714 - GLOBAL EQUITY INVESTMENTS**  
SPRING 2008

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**Pre-requisites:** DMSB 715 or IBUS 701 or instructor approval  
**Class Meeting Time:** Monday and Wednesday 12:30PM - 1:45PM Room BA 584

**COURSE DESCRIPTION**

This course aims to provide students with theory and quantitative tools needed for international investment and portfolio management, with a particular focus on equity investments and emerging markets. The course is organized in four sections. The **first section** starts by providing foundation for understanding exchange rates determination and emphasizes the importance of exchange rate risk in international investing and portfolio management. **Section 2** introduces students to international asset pricing theory and portfolio diversification. Topics that will be covered include: risk and return of an international security, optimal portfolio with international securities, the impact of international diversification on the efficient frontier, risk-return relationship in an international context, empirical tests of international asset pricing models, market efficiency and anomalies across international capital markets, and structure of international returns. **Section 3** will provide students with a set of practical tools for global asset allocation. Topics to be discussed include short-term forecasting models for asset returns, modeling volatility, correlation and skewness, global tactical asset allocation, and especially the importance of industry versus country risk factors and implications for global portfolio management.

Given the increasing integration of developed countries' equity markets and the growing importance of emerging markets in the global economy, **section 4** focuses on international investing in the specific context of emerging markets. We will cover the following topics: legal foundations and institutional characteristics, privatization and financial liberalization, financial development, benefits and risks of investing in emerging markets, and return and risk characteristics.

## READINGS AND COURSE MATERIALS

The lectures will be based on several sources as no single textbook comprehensively covers all the material in this course.

### 1. Textbooks

- SOLNIK, Bruno & MCLEAVEY, Dennis, *International Investments*, 5th Edition, Addison-Wesley, 2003. ISBN-10: 0321223896 ISBN-13: 9780321223890.
- BEIM, David O. & CALOMIRIS, Charles W., *Emerging Financial Markets*, McGraw-Hill, 2000. ISBN-10: 0072425148 ISBN-13: 9780072425147.

Although we will cover selected chapters from the above references, I recommend all students to have the first textbook handy. These textbooks will be on reserve at the Business Library.

2. These references will be supplemented by relevant working papers and articles from academic and practitioners finance journals. These articles will be available on the course website.

3. The students are also encouraged to frequently consult other sources such as *The Financial Times*, *The Economist*, and *The Wall Street Journal*.

## METHOD OF INSTRUCTION

The course essentially consists of lectures by the instructor and at least one guest speaker, presentations of key academic articles related to specific topics in portfolio management, asset pricing models, and emerging markets by the instructor and the students. You will be assigned selected problems, which will test and enhance your understanding of the theoretical concepts that we cover in class. Several practice problems are also scheduled throughout the semester.

## COURSE REQUIREMENTS

I assume that students have had exposure to the basic concepts of financial management, portfolio theory, and international finance. Several parts of the course are **quantitative and mathematical** in nature and you should be comfortable in mathematics and statistics. In particular, you should be familiar with computations of mean, variance, standard deviation, covariance, skewness, and other higher moments. Additionally, the course homework and term paper require that students are familiar with regression analysis, and therefore I expect that you are able to use Excel spreadsheets and econometric software such as STATA, SPSS, SAS, etc.

Although all course material is posted on the course webpage on Blackboard, students are expected to attend each class **regularly and punctually**, and actively participate in class activities. Much of the in-class activities involve articles presentations and practice problems and hence require your presence. If for some legitimate reasons you were to be late or had to leave class early, you should let me know in advance. Moreover, to be efficiently involved in these activities and to maximize your learning from the course, it is necessary that you prepare the assigned readings before each class. You are also encouraged to solve the assigned problems, which will also help you to be prepared for the homework and the final exam. Additional practice problems with solutions will be posted on the course website. However, make sure to work on the problems before you look at the solutions and do not hesitate to ask questions in class or to contact me!

To ensure an adequate learning environment, make sure that your cell phone and other electronic devices are **OFF** during the class and **eating is absolutely prohibited in class**. More generally, all students are expected to be **punctual, attentive** to the lectures and class discussions, and **respectful** toward their colleagues and the instructor.

## GRADING

The final grade in the course will be based on the following scheme:

|                    |             |
|--------------------|-------------|
| Participation      | 5%          |
| Group Presentation | 15%         |
| Homework           | 20%         |
| Term Paper         | 25%         |
| Final Exam         | 35%         |
| <b>Total</b>       | <b>100%</b> |

The above weights apply to all students and do not depend on your partial performance.

**Participation:** Takes into account answers to my questions, active participation in class discussions, and class consistent punctual attendance.

**Group Presentation:** Groups of 2 students will present an article on a topic that is covered in class. The topics will be selected in consultation with the instructor on a first-come first-serve basis. The presentation guidelines will be posted on the course website.

**Homework:** There will be two individual homeworks, consisting of a set of problems and/or empirical analysis using real data and contributing 10% each to the final grade. These homeworks are intended to provide you with the opportunity to deal with practical, real world applications in investments and particularly, stock market data manipulations. Additional information on the homeworks will be posted on the course webpage.

**Term Paper:** A group-based term paper analyzing the importance of industry versus country effects in international equity returns and the implications for portfolio management. More details on the term paper, including the data to be analyzed, will be discussed in class and posted on the course website.

**Final Exam:** There will be one final exam that covers all course material (i.e., text chapters, additional readings, articles and presentations, and assignments), contributing 35% to your final grade.

The experience shows that class attendance and participation in class discussions, careful attention to the course material, and preparedness before coming to class will greatly and logically improve your grades.

## UNIVERSITY OF SOUTH CAROLINA POLICIES

It is the instructor's responsibility to ensure compliance with the University of South Carolina Honor Code and to report any violation observed.

### Excerpts from the Honor Code indicate:

It is the responsibility of every student at the University of South Carolina Columbia to adhere steadfastly to truthfulness and to avoid dishonesty, fraud, or deceit of any type in connection with any academic program. Any student who violates this Honor Code or who knowingly assists another to violate this Honor Code shall be subject to discipline. All forms of academic dishonesty are prohibited. These include cheating, plagiarism, lying in academic matters, fraud, bribery, unauthorized access to tests and examinations.

This Honor Code is intended to prohibit all forms of academic dishonesty and should be interpreted broadly to carry out that purpose. The following examples illustrate conduct that violates this Honor Code, but this list is not intended to be an exhaustive compilation of conduct prohibited by the Honor Code:

1. Giving or receiving unauthorized assistance, or attempting to give or receive such assistance, in connection with the performance of any academic work.
2. Unauthorized use of materials or information of any type or the unauthorized use of any electronic or mechanical device in connection with the completion of any academic work.
3. Access to the contents of any test or examination or the purchase, sale, or theft of any test or examination prior to its administration.
4. Use of another person's work or ideas without proper acknowledgment of source.
5. Intentional misrepresentation by word or action of any situation of fact, or intentional omission of material fact, so as to mislead any person in connection with any academic work (including, without limitation, the scheduling, completion, performance, or submission of any such work).
6. Offering or giving any favor or thing of value for the purpose of influencing improperly a grade or other evaluation of a student in an academic program.
7. Conduct intended to interfere with an instructor's ability to evaluate accurately a student's competency or performance in an academic program.

Whenever a student is uncertain as to whether conduct would violate this Honor Code, it is the responsibility of the student to seek clarification from the appropriate faculty member or instructor of record prior to engaging in such conduct.

For more information regarding the University of South Carolina policies related to academic integrity is available on the Internet at: <http://www.sc.edu/academicintegrity/>

## TENTATIVE OUTLINE OF TOPICS

The following presents a tentative outline of topics that will be covered. Some topics will be covered more in-depth than others depending on time constraints and the progress of the class. Any changes will be previously announced and posted on the course website. Please make sure to check the section "Announcements" on the course website before every class!

### Section 1: Foundation of Exchange Rates

- Chapter 1: Foreign Exchange - Solnik & McLeavy
- Chapter 2: Foreign Exchange Parity Relations - Solnik & McLeavy
- Chapter 3: Foreign Exchange Determination and Forecasting - Solnik & McLeavy

### Section 2: Portfolio Theory and International Investment

- Chapter 9: The Case for International Diversification - Solnik & McLeavy

Dahlquist, M., L. Pinkowitz, R. Stulz and R. Williamson, 2003, Corporate governance and the home bias, *Journal of Financial and Quantitative Analysis* 38, 87-110.

Goetzmann, W. N., L. Li, and K. G. Rouwenhorst, 2005, Long-term global market correlations, *Journal of Business* 78, 1-38.

Ke, D., L. Ng and Q. Wang, 2006, Home bias in foreign investment decisions, AFA 2007 Chicago Meetings. Paper Available at SSRN: <http://ssrn.com/abstract=891383>.

Kelly, M., 1995, All their eggs in one basket: portfolio diversification of US households, *Journal of Economic Behavior and Organization* 27, 87-96.

- Chapter 4: International Asset Pricing - Solnik & McLeavy

#### International Asset Pricing: Theory

Adler, M. and B. Dumas, 1983, International portfolio choice and corporation finance: A synthesis, *Journal of Finance* 38, 925-984.

Solnik, B., 1974, An equilibrium model of the international capital market, *Journal of Economic Theory* 8, 500-524.

Stulz, R. M., 1984, Pricing capital assets in an international setting: An introduction, *Journal of International Business Studies*, 55-72.

#### International Asset Pricing: Empirical Evidence

De Santis, G. and B. Gerard, 1998, How big is the premium for currency risk?, *Journal of Financial Economics* 49, 375-412.

Dumas, B. and B. Solnik, 1995, The world price of foreign exchange risk, *Journal of Finance* 50, 445-479.

Erb, C., C. R. Harvey and T. E. Viskanta, 1996, Expected returns and volatility in 135 countries, *Journal of Portfolio Management* 22, 46-58.

Person, W. and C. R. Harvey, 1994, Sources of risk and expected returns in global equity markets, *Journal of Banking & Finance* 18, 775-803.

Sy, O. and V. Errunza, 2007, A three-moment international asset pricing model: international evidence, Working paper, Dalhousie University and McGill University.

### Market Efficiency and Anomalies

Daniel, K. and S. Titman, 1997, Evidence on the characteristics of cross sectional variation in stock returns, *Journal of Finance* 52, 1-33.

Davis, J. L., E. F. Fama and K. R. French, 2000, Characteristics, covariances, and average returns: 1929-1997, *Journal of Finance* 55, 389-406.

Guedhami, O. and Sy, O., 2006, Risk versus momentum characteristic: international evidence. Working paper, Dalhousie University.

Fama, E. F. and K. R. French, 1996, Multifactor explanations of asset pricing anomalies, *Journal of Finance* 51, 55-84.

Fama, E. and K. French, 1998, Value versus growth: the international evidence, *Journal of Finance* 53, 1975-1999.

Sy, O. and V. Errunza, 2007, Does diversification explain market anomalies? Working paper, Dalhousie University and McGill University.

## **Section 3: Global Asset Allocation**

- Chapter 13: Structuring the Global Investment Process - Solnik & McLeavy

### Industry versus Country Effects in Explaining International Equity Returns

Baca, S. P., B. L. Garbe and R. A. Weiss., 2000, The rise of sector effects in major equity markets, *Financial Analysts Journal* 56, 34-40.

Brooks, R. and M. Del Negro, 2004, The rise in comovement across national stock markets: market integration or IT bubble?, *Journal of Empirical Finance* 11, 649-680.

Brooks, R. and M. Del Negro, 2005, Country versus region effects in international stock returns, *Journal of Portfolio Management* 31, 67-72.

Cavaglia, S., C. Brightman and M. Aked, 2000, The increasing importance of industry factors, *Financial Analysts Journal* 56, 41-54.

L'Her, J.-F., O. Sy and M. Y. Tnani, 2002, Country, industry, and risk factor loadings in portfolio management, *Journal of Portfolio Management* 28, 70-79.

### Predicting Returns, Volatilities and Correlations

Erb, C., C. R. Harvey and T. Viskanta, 1994, Forecasting international equity correlations, *Financial Analysts Journal* 50, 32-45.

Ferson, W. E. and C. R. Harvey, 1993, The risk and predictability of international equity returns, *Review of Financial Studies* 6, 527- 566.

Harvey, C. R. and A. Siddique, The cross-section of expected risk exposure, Working paper.

### Section 4: Emerging Markets

- Chapters 1&4: Definition, Legal, and Institutional Characteristics of Emerging Markets - Beim & Calomiris
- Chapters 2&3: Liberalization, Privatization, Corporate Governance and Equity Markets Development - Beim & Calomiris

Boubakri, N., J.-C. Cosset and O. Guedhami, 2005, Postprivatization corporate governance: the role of ownership structure and investor protection, *Journal of Financial Economics* 76, 369-399.

Boubakri, N., J.-C. Cosset, O. Guedhami and M. Omran, 2007, The determinants of foreign participation in privatizations: does the institutional environment matter?, *Journal of Financial Research* 30, 129-146.

Boutchkova, M. K. and W.L. Megginson, 2000, Privatization and the rise of global capital markets, *Financial Management* 29, 31-75.

Guedhami, O. and J. A. Pittman, 2007, The choice between private and public capital markets: the importance of disclosure standards and auditor discipline to countries divesting state-owned enterprises. Working Paper, Hong Kong University of Science and Technology, University of South Carolina.

Henry, B., 2000, Stock market liberalization, economic reform, and emerging equity prices, *Journal of Finance* 55, 529-564.

La Porta, R., F. Lopez-de-Silanes, A. Shleifer and R. Vishny, 1997, Legal determinants of external finance, *Journal of Finance* 53: 1131-1150.

Levine, R. and S. Zervos, 1998, Capital control liberalization and stock market development, *World Development* 26, 1169-1183.