



APPLIES TO ACADEMIC YEAR 2011/2012

GRA 6539 Fixed Income Securities

Programme

Master of Science in Business and Economics, Master of Science in Business and Economics (Finance), Master of Science in Financial Economics, Specialization Course

Responsible for the course

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Department

Department of Financial Economics

Term

According to study plan

ECTS Credits

6

Language of instruction

English

Introduction

A fixed income security is a security for which the future payments are set, when the security is issued. The classical example of a fixed income security is a treasury bond, which offers fixed interest payments. Since it has been issued by the treasury, there is no uncertainty about the future cash flows from the bond. The analysis of sovereign fixed income securities is simplified by the fact that there is only one important source of uncertainty, future interest rates.

While pricing of some fixed-income instruments is simpler, it is never simple. This course and jobs in fixed income are some of the most technically demanding within finance. While learning about fixed income may seem dry at times, a good understanding is paramount.

Detailed analysis of fixed income securities is often nearly omitted from academic programs. Yet fixed-income instruments (and their derivatives) form the majority of the capital markets in the developed economies. Importance of understanding fixed-income instruments by a wider audience of investors/households has been repeatedly brought to light in the recent years.

The recent global crisis was brought about by troubles in the fixed-income markets. The words on everyone's tongue are 'mortgages' and 'mortgage-backed securities,' fixed-income instruments. More close to home, the Terra Securities scandal of 2007 has hopefully taught us, that investing in fixed-income instruments without proper analysis and knowledge is a bad idea.

Learning outcome

By the end of the course, the students will gain understanding of the major institutional characteristics and some key technical know-how of the design and the valuation of debt instruments. To that end, in addition to understanding the economic intuition, the students will be expected to solve problems, which will go into the formal modeling issues, including interest rate modeling.

Acquired Knowledge includes:

1. Ability to identify the determinants of risk and return of debt securities. The emphasis is on pricing of fixed income securities, including fixed income derivatives.
2. Fixed income portfolio management techniques
3. The role of fixed-income securities in risk management.

Acquired Skills include:

1. The students will use and/or develop certain quantitative skills, e.g. will learn to utilize Excel tools for solving simple but realistic problems that may arise in the fixed income market, will learn to apply binomial tree and Monte Carlo simulation approaches to asset valuation and risk assessment.
2. The students will also be able to explain interdependencies risk factors

Reflection:

1. Students should gain a unified understanding of the interdependencies of factors affecting fixed income securities
2. Students should be able to analyze problems that go beyond those explicitly covered in class/the required book

Prerequisites

Compulsory reading

Books:

Veronesi, Pietro. 2010. Fixed income securities : valuation, risk, and risk management. Wiley-Blackwell

Other:

During the course there may be hand-outs and other material on additional topics relevant for the course and the examination.

A list of compulsory readings will be provided on It's learning or in class.

Recommended reading

Books:

Benninga, Simon. 2008. Financial modeling. 3rd ed. MIT Press

Cusatis, Patrick J., Martin Thomas. 2005. Hedging instruments and risk management.

McGraw-Hill

Sengupta, Chandan. 2004. Financial modeling : using Excel and VBA. Wiley

Tuckman, Bruce. 2002. Fixed income securities : tools for today's market. 2nd ed. Wiley

Course outline

The following gives an overview of the key topics to be covered in the course. The required textbook is good in some aspects, but is not detailed enough in others. It will therefore be supplemented by a number of articles and teaching materials.

The following topics will be covered:

- Institutional details: An overview of debt securities markets
- Tools: Bond pricing and arbitrage
- Tools: Measures of price sensitivity: Duration and convexity
- Institutional details: bond auctions
- Tools: Term structure models
- Institutional details and Tools: The market for repurchase agreements
- Tools: Fixed income forwards and futures
- Institutional details: Eurodollar Futures Markets and interest rate swaps
- Tools: Interest rate swap spreads and their determinants
- Institutional details and Tools: Corporate debt and fixed income options

Additional topics may be covered as time permits, including:

- Securitization
- Agency debt market
- Mortgage backed securities

Computer-based tools

Excel, It's learning

Learning process and workload

A course of 6 ECTS credits corresponds to a workload of 160-180 hours.

Students are expected to read the assigned chapters before class. Active class participation is expected during lectures, in the interactive regime.

There will be problem sets. The questions are to be answered by students prior to class and discussed together with the lecturer during classes.

Examples highlighting and demonstrating often-used, practical applications of fixed-income-securities' pricing are used extensively in the class.

There will be other written assignments during the semester. Those will be compulsory and graded as outlined below.

Please note that while attendance is not compulsory in all courses, it is the student's own responsibility to obtain any information provided in class that is not included on the course homepage/It's learning or text book. Notice also that the course homepage and/or It's learning are not designed for the purpose of accommodating the needs of students choosing not to attend class.

Examination

The course grade will be based on the following activities and weights:

65% will be based on a final exam (3 hours) , the remainder (35%) will be based on the coursework (in the form of a mix of some/all of the following: write up projects, and homeworks;

case presentation and class participation; in class midterm and quizzes).

All parts of the evaluation need to be passed in order to get a grade in the course.

Class participation is an integral part of the successful progression in the course. There will be mandatory midterm exam(s). Specific information regarding any aspect of student evaluation will be provided in class. It is the student's responsibility to obtain this information.

This is a course with continuous assessment (several exam elements). Each exam element will be graded using points on a scale (e.g. 0-100). The elements will be weighted together according to the information in the course description in order to calculate the final letter grade for the course. You will find detailed information about the point system and the cut off points with reference to the letter grades on the course site in It's learning.

Two midterm exams and class participation.

Examination code(s)

GRA 65391 class work and exam accounts for 100% of the final grade in the course GRA 6539.

Examination support materials

A bilingual dictionary and a BI-approved exam calculator. Exam aids at written examinations are explained under exam information in our web-based Student handbook. Please note the use of calculator and dictionary. <http://www.bi.edu/studenthandbook/examaids>

Re-sit examination

It is only possible to retake an examination when the course is next taught.

The assessment in some courses is based on more than one exam code.

Where this is the case, you may retake only the assessed components of one of these exam codes.

Where this is not the case, all of the assessed components of the course must be retaken.

All retaken examinations will incur an additional fee.

Additional information

Honor Code

Academic honesty and trust are important to all of us as individuals, and represent values that are encouraged and promoted by the honor code system. This is a most significant university tradition. Students are responsible for familiarizing themselves with the ideals of the honor code system, to which the faculty are also deeply committed.

Any violation of the honor code will be dealt with in accordance with BI's procedures for cheating. These issues are a serious matter to everyone associated with the programs at BI and are at the heart of the honor code and academic integrity. If you have any questions about your responsibilities under the honor code, please ask.