

*Simon Fraser University  
Faculty of Business Administration*

**BUS 418  
INTERNATIONAL FINANCIAL MANAGEMENT**

INSTRUCTOR: Prof. GEOFFREY POITRAS  
email: [poitras@sfu.ca](mailto:poitras@sfu.ca) website: [www.sfu.ca/~poitras](http://www.sfu.ca/~poitras)  
Office: WMX 3333 Phone: 291-4071

**Course Outline:** This course examines the management of assets and liabilities in a multinational setting. Two primary topics are to be covered: the evaluation and management of foreign exchange (FX) risk with some attention also given to speculative FX trading strategies; and, the valuation of foreign equity securities. Some attention will be given to the evaluation of FX risk within an investment optimization framework.

**Required Text:**

G. Poitras, Risk Management, Speculation and Derivative Securities, Academic Press, 2002. (RSD)

**Supplementary Texts:**

B. Solnik, International Investments (4th ed.), Addison-Wesley, 2000. (Solnik)  
J. Hull, Options, Futures and Other Derivatives, (4th ed.), Prentice-Hall, 2000.

**Some Additional Recommended Texts:**

P. Bernstein, Capital Ideas, The Improbable Origins of Modern Wall Street, New York: Free Press, 1992.  
Z. Bodie, A. Kane and A. Marcus, Investments Irwin, 1993 (2nd ed.)  
E. Elton and M. Gruber, Modern Portfolio Theory and Investment Analysis New York: Wiley, 1995.  
Ian Giddy, Global Financial Markets, D.C. Heath (1994) (Giddy)  
O. Grabbe, International Financial Markets, New York: Elsevier, 1991. (Grabbe)  
B. Graham, D. Dodd and S. Cottle, Security Analysis New York: McGraw-Hill, 1962.  
B. Malkiel, A Random Walk Down Wall Street, New York: Norton, 1995.  
S. Mason, R. Merton, A. Perold and P. Tufano, Cases in Financial Engineering, Prentice-Hall, 1995.  
K. Palepu, P. Healy and V. Bernard, Business Analysis and Valuation, Cincinnati: Southwestern, 2000.  
S. Penman, Financial Statement Analysis and Security Valuation, New York: McGraw-Hill, 2001.

**Readings Package:**

In addition to the required text, there are also required/recommended articles to read which are contained in a Readings Package which is on Reserve in the Library. Articles which are contained in the Readings Package are indicated by a (\*) in the Detailed Course Outline.

## DETAILED COURSE OUTLINE

### BACKGROUND READING

*To obtain a background knowledge of financial markets.*

Elton and Gruber, Chap. 2-3

Mason, Merton, Perold and Tufano, "The US Government Debt Market and the Structure of Interest Rates", p.87-116.

*On the Mechanics of the Foreign Exchange Market,*

Grabbe Chapters 8 and 12                  Solnik Chapters 4 and 6                  Giddy, Chapter 2, 10, 12, 14 and 15

*International Parity Relationships:*

Giddy, Chapter 5                  Grabbe, Chapters 5 and 20

*Review of Mean-Variance Portfolio Optimization*

Elton and Gruber, Modern Portfolio Theory, Chp. 4,5,6.

Bodie, Kane and Marcus, Investments, Chp. 23-4.

Grabbe, International Financial Markets, Chp. 11.

### Week I. Introduction

–Class Organization: Creation of Groups, Discussion of Evaluation, Review of Syllabus

Time permitting, some attention may be given to the following topics:

*Characteristics of Derivative Security Users:*

RSD, Chapter I, Section IV.

*The Trend to Globalization:*

\*Jorion and Goetzmann, "Global Stock Markets in the Twentieth Century", Journal of Finance, June 1999.

Grabbe, Chapter 2

Speidell and Sappenfield, "Global Diversification in a Shrinking World", Journal of Portfolio Management, Fall 1992.

## **Week II: Covered Interest Arbitrage**

- Using Currency Futures and Forward Contracts
- Early Forward Exchange Markets
- Covered Interest Arbitrage Transactions

–Required Reading: RSD, Chapter 6, p.329-333; RSD: Chapter 4, Section II, p.224-243.

Other Readings:

RSD, Chapter 4, Section I.

Poitras, "Arbitrage Boundaries, Treasury Bills and Covered Interest Parity", Journal of International Money and Finance, 1988.

Popper, "Long-term Covered Interest Parity and the International Swap Market", Journal of International Money and Finance, 1993.

## **Week III. Methods of Handling Currency Exposure: Futures and Forward Contracts**

- Transactions Hedging versus Optimal Hedging
- When is Hedging Foreign Assets Effective?

–Required Reading: RSD, Chapter 6, Sections I-II, pp. 293-309, 333-343.

Other Readings:

\*Benari, "When is hedging foreign assets effective", Journal of Portfolio Management, Fall 1991.

\*Madura and Tucker, "Hedging International Stock Portfolios: Lessons from the 1987 Crash", Journal of Portfolio Management, Spring 1992.

\*Perold and Schulman, "The Free Lunch in Currency Hedging", Financial Analysts Journal, May/June 1988.

## **Week IV: Methods of Handling Currency Exposure (cont'd)**

- The Problems of Hedging of Foreign Assets
- Methods for Speculating with Currency Futures and Forwards

–Required Reading: RSD, Chapter 6, p.333-343; Chapter 3, Section II; Chapter 5, p.265-7, 284-6.

Other Readings:

\*Eaker, Grant and Woodward, "A Multinational Examination of International Equity and Bond Investment with Currency Hedging", Journal of Futures Markets, 1993.

Hauser, et.al., "Investing in Emerging Stock Markets: Is it Worthwhile Hedging Foreign Exchange Risk?", Journal of Portfolio Management, Spring 1994.

## **Week V. Methods of Handling Currency Exposure: Swaps**

- Why Swap?
- Fully Hedged Borrowing versus Currency Swaps
  
- Required Reading: RSD, Chapter 6, Section IV.

Other Readings:

Grabbe, International Financial Markets, Chap. 15

\*P. Abken, "Beyond Plain Vanilla: A Taxonomy of Swaps", Federal Reserve Bank of Atlanta Economic Review, 1991.

Mason, et al., "Currency Swaps", in Cases in Financial Engineering, pp. 581-600.

M. Arak, Estrella, Goodman and Silver, "Interest Rate Swaps: An Alternative Explanation", Financial Management, Summer 1988.

N. Usmen, "Currency Swaps, Financial Arbitrage and Default Risk", Financial Management, Summer 1994.

## **Week VI. Methods of Handling Currency Exposure: Options**

- Review of Distribution Free Properties of Option Contracts
- Put-Call Parity for Currency Option Contracts

Required Reading: Chapter 7, Sections I and II; Chapter 8, p.477-9.

Other Reading:

\*Grabbe, International Financial Markets, Chap. 6

## **Week VII: Valuation of Currency Options**

- Garman-Kohlhagen Pricing Formula
- Early Exercise of American Currency Options
  
- Required Readings: Chapter 8, Sections II and V.

## **Week VIII: Fundamental Analysis of Foreign Stocks**

- Overview of Approaches to Security Analysis; Cash Flow Models of Equity Valuation.
- Techniques of Fundamental Analysis
- Graham and Dodd on Value Investing

Required Readings: Class Handout.

Suggested Background Readings:

(\*\*) indicates the reading is available in a Supplementary Readings Package.

\*\*Graham and Dodd, Security Analysis (1934), Chp. XXVII

Abarbanell and Bushee, "Fundamental Analysis, Future Earnings and Stock Prices", Journal of Accounting Research, Spring 1997.

\*\*Damodaran, Damodaran on Valuation, Chp. 1,3,6,7

Dynkin, Hyman and Wu, "Value of Skill in Security Selection versus Asset Allocation in Credit Markets", Journal of Portfolio Management, Fall 2000.

\*\* Stickney, "The Academic's Approach to Securities Research: Is it Relevant to the Analyst?", Journal of Investing, Summer 1997.

\*\* Penman and Sougiannis, "A Comparison of Dividend, Cash Flow and Earnings Approaches to Equity Valuation", Contemporary Accounting Research, Fall 1998.

\*\* Herzberg, Guo and Brown, "Enhancing Earnings Predictability Using Individual Analyst Forecasts", Journal of Investing, Summer 1999.

\*\* Christofi, Christofi, Lori and Moliver, "Evaluating Common Stock's Using Value Line's Projected Cash Flows and Implied Growth Rate", Journal of Investing (1999).

Jensen, "Agency Costs of Free Cash Flow, Corporate Finance and Takeovers", American Economic Review May 1986.

S. Penman, Financial Statement Analysis and Security Valuation, New York: McGraw-Hill, 2001.

---

## WEEKS 9-11: GROUP PRESENTATIONS

---

### Week 12. Review of Mean-Variance Optimization; International Diversification

- Characteristics of Internationally Diversified Portfolios
- Benefits of International Diversification
- Review of Mean-Variance Optimization Model; International Diversification
  
- Required Reading: RSD, Chapter 6, Section III, p.343-360.

Other Readings:

\*Coval and Moskowitz, "Home Bias at Home: Local Equity Preference in Domestic Portfolios", Journal of Finance, Dec. 1999.

R. Ibbotson, et.al., "International Equity and Bond Returns", Financial Analysts Journal (July/Aug. 1982): 61-83.

\*Burik and Ennis, "Foreign Bonds in Diversified Portfolios", Financial Analysts Journal, Mar/Apr 1990.

**Week 13: International Portfolio Management**

- Evaluating FX risk within an Investment Optimization Framework
- Hedging Currency Exposure in Optimally Diversified Portfolios
  
- Required Reading: RSD, Chapter 6, Section III, p.343-360.

Other Readings:

\*Eun and Resnick, "International Diversification of Investment Portfolios: US and Japanese Perspectives", Management Science, Jan. 1994.

Jorion, "International Portfolio Diversification with Estimation Risk", Journal of Business, 1985.

Board and Sutcliffe, "Estimation Methods in Portfolio Selection and the Effectiveness of Short Sales Restrictions", Management Science, Apr. 1994.

\*R. Grauer and N. Hakansson, "Gains from International Diversification: 1968-85", Journal of Finance (July 1987): 721-39.