BUSFIN 4227/7224 Trading and Markets

**Instructor:** Professor Ingrid M. Werner   Phone: (614) 292-6460

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**Office Hours:** By Appointment   **Meeting Time & Place:**
Tu/Th 10:15-11:45 am SB 219

**Course Outline**

In this course, we describe how today’s financial markets work; how governments and exchanges regulate them; and how traders create liquidity, volatility, informative prices, trading profits, and transaction costs. The course provides an overview of today’s fragmented market for financial securities. On the equity trading side, we discuss major exchanges such as NYSE, Nasdaq OMX, and Euronext but also newer players such as BATS, ISE, and IXE and Dark Pools such as Credit Suisse’s Cross Finder and Goldman Sachs’s Sigma X. We also discuss options and futures exchanges like the CBOE the CME, and ICE, electronic bond trading platforms such as eSpeed and Bondvision, and currency trading systems such as EBS and Reuters 3000.

We study different market structures: single price auctions, open outcry auctions, screen-based markets, and brokered markets. We study the role of different market participants: investors, brokers, dealers, arbitrageurs, retail traders, buy-side traders (institutions), day traders, and rogue traders. We also study different order types: limit orders, market orders, and stop orders; and trading strategies: program trading, basket trading, block trading, and short sales. Finally, we look at the dark side of securities trading: insider trading, front running, market manipulation, and bluffing.

**Target Students**

This course is primarily targeted towards students thinking of a career in investment management, securities trading, or the brokerage industry. It is also an excellent course to take for students targeting a career as a financial advisor. However, the course will also be useful for students interested in finance more generally. In the course, we will show that market structure and regulation affect asset pricing, and hence the cost of capital for firms around the world. Students taking this course will most certainly get a “leg-up” on the competition for summer jobs and hopefully also permanent jobs in the securities industry.
Learning Goals

There are three main goals for students in this course:

1. To develop a thorough understanding of how securities are traded around the world, how traders (retail and institutional) can minimize their costs of trading, and how market makers can optimally set prices and execute orders.
2. To understand the role of regulation, and how it impacts players in the securities industry.
3. To gain first-hand experience in trading simulated securities and making a market for simulated securities.

Prerequisites

This year, the course is offered to a combined section of undergraduate and MBA students. MBA students must have taken MBA 6221 and 6222 (or MBA 6223), and undergraduate students must have taken BUSFIN 3220. In addition, background in microeconomics is useful because the notions of supply, demand and economic equilibrium underlie just about every trading situation. Statistics comes in handy when we need to design strategies in situations involving risk or evaluate performance of existing markets.

Instructor

Ingrid Werner is the Martin and Andrew Murrer Professor and Interim Department Chair of Finance at Ohio State University. She joined The Ohio State University in 1998. She has also taught at Stanford Business School, the Wharton School, University of Michigan Ross School of Business, Bocconi University, University of Bologna, University of Toronto’s Rotman School of Management, and the Stockholm School of Economics. She has an MBA and an Economics Licentiate degree from the Stockholm School of Economics, and a MA and a PhD in Economics from the University of Rochester. Professor Werner does research primarily in international finance and market microstructure. She was the visiting research economist at the New York Stock Exchange in 1997, and the visiting academic fellow at the Nasdaq Stock Market in 2001-2002.

Workload Expectation

The university and college expectation is that students spend two hours outside of class for every hour spent in class. Since this course meets 3 hours per week, you should expect to spend 6 hours per week outside of class on course-related work.
Course Material

Required Materials:
Class-notes and other required reading materials will be distributed via Carmen.

Background Readings:
Examples of textbooks that you may want to consult include:
- *Equity Markets in Action*, 2004, Wiley, by Professor Robert A. Schwartz and Reto Francioni. The textbook is available for free as an ebook through the Ohio State University Library.

I refer to chapters in the Schmidt book below, but similar information can be found in the other textbooks listed above or online. Additional content will be in the slides.

Evaluation Criteria

The final course grade will be allocated according to the following:

- Assignments 20%
- Individual Classroom Contribution 10%
- Trading Simulations 30%
- Cases
  - MBA students write-ups 20%
  - UG students quizzes 20%
- Term Paper 20%

Examination Policy

There are no make-ups for quizzes. Missed quizzes will be recorded as a “0”. Missed exams can only be made-up in extreme cases (e.g., death of family member, personal hospitalization, etc.) with proper documentation (e.g., a physician’s note, ER paperwork, obituary, etc.). Each decision of potentially allowing a make-up exam is made by the instructor on a case-by-case basis. Additionally, you MUST contact the instructor (werner@fisher.osu.edu) as soon as you know of a potential problem or conflict with an exam date. Alternative methods (e.g., oral exam, essay) of testing may be used for make-up exams. If you are experiencing an extreme situation or emergency, please attempt to notify the instructor (werner@fisher.osu.edu) via email ASAP.
Assignments

There are four individual assignments. Assignments are graded on a three point scale (1, 2, or 3). Late assignments (submitted after the class in which they are due) will automatically lose one (1) point.

Class Participation

A substantial portion of your grade (10%) will be based on class participation. Class participation will mainly be graded based on your contributions to case discussions, but general participation in the form of questions and comments during lectures is also welcome and will be rewarded. A combination of cold-calling and soft-calling will be used to maximize participation. Each student will be given ample opportunity to contribute to the classroom discussion. I will monitor contributions daily, and will cold-call students who need encouragement to speak up in class.

Trading Simulations

We will use several trading simulations in the course, and your simulation performance during the Trading competition accounts for 30% of your grade. The trading simulations are not simply graded on profits generated by each trader, but also on learning and on position risk management. The simulation software -- Rotman Interactive Trader (RIT) - - is based on a software package designed by the staff in the trading laboratory at the Rotman School, University of Toronto. Fisher College holds a site license to RIT software. Students are encouraged to practice using the RIT software throughout the course. More information about the simulations will be provided on the class Carmen web-page.

Cases

There will be two cases assigned in the later part of the course. In preparation for the in-class case discussions, study questions are available on Carmen. Each MBA student is expected to analyze the case and write a 3 page summary of his or her findings which is due before class. Undergraduate students will instead be given a short quiz at the beginning of class (5-6 questions, 10 minutes) to get credit for their preparation. All students are expected to participate actively in the in-class case discussion.

Term Paper

Each student will be required to write an individual Term Paper (max 5 pages [11 point font and 1.5 line spacing] with exhibits, not including the reference page does not count toward the limit). More information will be available on the Carmen course page.

*The Term Paper is due before noon on Friday, Dec 11, 2015. Only dropbox submissions will be accepted.*
Other policies

Attendance:

Any student who fails to attend without giving prior notification to the instructor will be dis-enrolled after the third instructional day of the term, the first Friday of the term, or the second scheduled class meeting of the course, whichever occurs first.

If you are unable to attend a particular class, please notify the instructor of your absence prior to that class. Failure to notify the instructor of absences, or missing more than five (5) sessions during the course, might result in a failing grade. Note, I take attendance virtually every class.

Absence from the trading competition will not be excused, except for the most serious circumstances. Such circumstances must be validated in writing by an appropriately accredited professional (e.g., medical doctor).

Academic Conduct:

Academic integrity is essential to maintaining an environment that fosters excellence in teaching, research, and other educational and scholarly activities. Thus, The Ohio State University and the Committee on Academic Misconduct (COAM) expect that all students have read and understand the University’s Code of Student Conduct, and that all students will complete all academic and scholarly assignments with fairness and honesty. Students must recognize that failure to follow the rules and guidelines established in the university’s Code of Student Conduct and this syllabus may constitute “academic misconduct.”

The Ohio State University’s Code of Student Conduct (Section 3335-23-04) defines academic misconduct as: “Any activity that tends to compromise the academic integrity of the University, or subvert the educational process.” Examples of academic misconduct include (but are not limited to) plagiarism, collusion (unauthorized collaboration), copying the work of another student, submitting the same or similar work for credit in more than one class, and possession of unauthorized materials during an examination. Ignorance of the University’s Code of Student Conduct is never considered an “excuse” for academic misconduct, so I recommend that you review the Code of Student Conduct and, specifically, the sections dealing with academic misconduct.

If a student is suspected of, or reported to have committed academic misconduct in this course, I am obligated by University Rules to report my suspicions to COAM. If you have any questions about the above policy or what constitutes academic misconduct in this course, please contact me.
Appeals:

Grading errors should be corrected. Appeals must be in writing, within 1 week after the graded work is returned—not the date you first look at it. The appeal should include a description of the question(s) that need to be reexamined as well as an explanation of why the original grade was incorrect. In general, the entire document will be checked for grading errors, and correcting these could either raise or lower the overall score.

Disability Services:

Students with disabilities that have been certified by the Office for Disability Services will be appropriately accommodated and should inform the instructor as soon as possible of their needs. The Office for Disability Services is located in 150 Pomerene Hall, 1760 Neil Avenue; telephone 292-3307, TDD 292-0901; [http://www.ods.ohio-state.edu/](http://www.ods.ohio-state.edu/).

Waitlisted students:

Students who are waitlisted and seek to enroll must attend class through the first class session of the second week of the session. After that date, students who have not been added will not be enrolled and may not continue to attend the class. Waitlisted students should contact either the Fisher Undergraduate Program Office or the Department of Finance office if they have any questions regarding the waitlist process.
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Week 1: Primitives and Market Structure

10/20 Topics:
- The Role of an Equity Market
- Orders, Bids, Offers, Spreads
- US Market Structure

Readings:
Schmidt Chapters 1 and 2.
Securities Trading: Front, Middle, and Back Office, HBS 9-110-070

10/22 Trading Simulation: Order Driven Markets
LT3 - Dynamic Order Arrival
Assignment 1

Week 2: Information and Prices

10/27 Topics:
- Call Auctions
- Continuous Trading
- From Information to Prices

10/29 RIT Trading Simulation: Price Discovery
PD0 - Market Equilibrium
PD1 - IPO Pricing
PD2 - Asymmetric Information
PD3 - ETF Arbitrage Pricing
Assignment 2

Week 3: Intermediated Markets

11/3 Topics:
- Risk-Neutral Models
- Models with Risk-Aversion
- Empirical Market Microstructure
- Kyle’s Model
- Glosten-Milgrom Model

Readings:
Schmidt Chapters 3, 4 and 5.
Week 4: Institutional Trading

11/10 Topics:
- Best Execution
- Order Submission Strategies
- Trading Cost Analysis

Readings:
Bacidore J. and G. Sofianos, Large Order Execution Quality, *Goldman Sachs*
Bacidore J. and G. Sofianos, Choosing The Best Execution Strategy, *Goldman Sachs*

Week 5: Regulation

11/17 **Insider Trading**
Readings:
*Note on Insider Trading Liability, HBS 9-305-029*
*Insider Trading Quiz, HBS Case 9306-016*

Case:  *Martha Stewart (A), HBS Case 9-305-034.*

11/19 **Market Manipulation, Ponzi Schemes, and Rogue Traders**
Readings:

Case: *Societe Generale (A): The Jerome Kerviel Affair, HBS Case 110029.*
Week 6: Current Topics

11/22  **Dark Pools, Algorithms, and High Frequency Trading**

Readings:

Week 7: Trading Competition

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<td>RIT Trading Simulation</td>
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<td><em>Competition- Part I</em></td>
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<td>12/3</td>
<td>RIT Trading Simulation</td>
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<td><em>Competition – Part II</em></td>
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Week 8: Current Topics continued

12/8  **The Flash Crash**

Readings:
- Findings Regarding the May 6, 2010 Events, Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues.