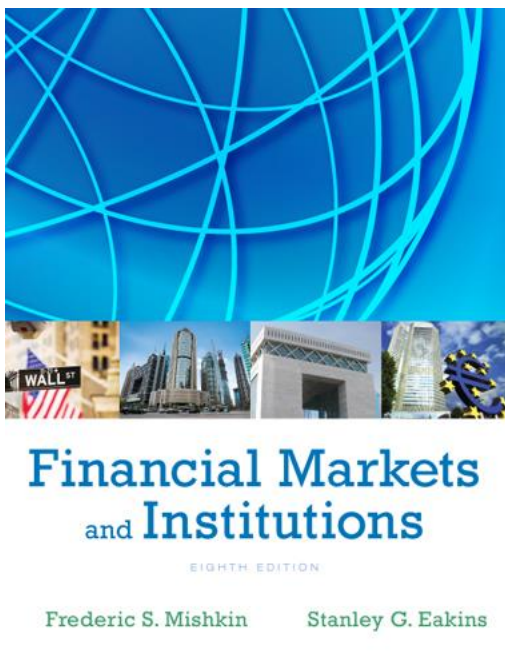


ALWAYS LEARNING

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Part 1

Introduction



ALWAYS LEARNING

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Chapter 1

Why Study Financial Markets and Institutions?



Chapter Preview

The evening news features a segment about the bond market and interest rates. What does this mean for your small retail business? Should you borrow money? Issue stock instead of using a bank loan?

What does all this mean? Do I care about interest rates? What about the turmoil in Europe? Are imports more expensive?



Chapter Preview

These are good questions. Of course, the answer to these questions can be found in this book. In fact, this book touches on a variety of topics, including the Fed, stocks markets, bond markets, and banks. We will begin to appreciate many exciting issues related to these topics during the course of this term.



Chapter Preview

We preview subjects of interest to anyone who is a part of a productive society. Topics include:

- Why Study Financial Markets?
- Why Study Financial Institutions?
- Applied Managerial Perspective
- How Will We Study Financial Markets and Institutions



Chapter Preview

We preview subjects of interest to anyone who is a part of a productive society. Topics include: Web Exercise

- Concluding Remarks



Why Study Financial Markets?

Financial markets are crucial in our economy.

1. Channel funds from savers to investors, promoting economic efficiency.
2. Market activity affects: personal wealth, business firms, and economy



Why Study Financial Markets?

- Well functioning financial markets are key factors in producing high economic growth.
- We will briefly examine each of these markets, key statistics, and how we will examine them throughout this course.



Why Study Financial Markets? Debt Markets & Interest Rates

- Debt markets allow governments, corporations, and individuals to borrow.
- Borrowers issue a security, called a bond, offering interest and principal over time.
- The interest rate is the cost of borrowing.



Why Study Financial Markets? Debt Markets & Interest Rates

- Many types of market interest rates: mortgage rates, car loan rates, credit card rates, etc.
- The level of these rates are important. For example, mortgage rates in the early part of 1983 exceeded 13%.



Why Study Financial Markets? Debt Markets & Interest Rates

- Understanding the history of interest rates is beneficial.
- We will study these further in the book: types and characteristics of bonds; theories on how rates are determined.

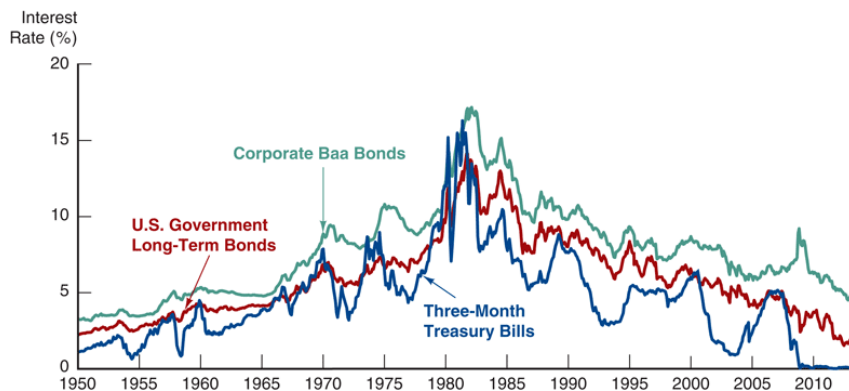
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Bond Market and Interest Rates

Figure 1.1 Interest Rates on Selected Bonds, 1950–2013



Source: Federal Reserve Bank of St. Louis, FRED database: <http://research.stlouisfed.org/fred2/>.

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Why Study Financial Markets? Debt Markets & Interest Rates

- For the moment, we will turn to other topics, but revisit these topics.
- In chapters 2, 11, 12, and 14, we will examine the role of debt markets in the economy.
- In chapters 3 through 5, we will examine the characteristics of interest rates.



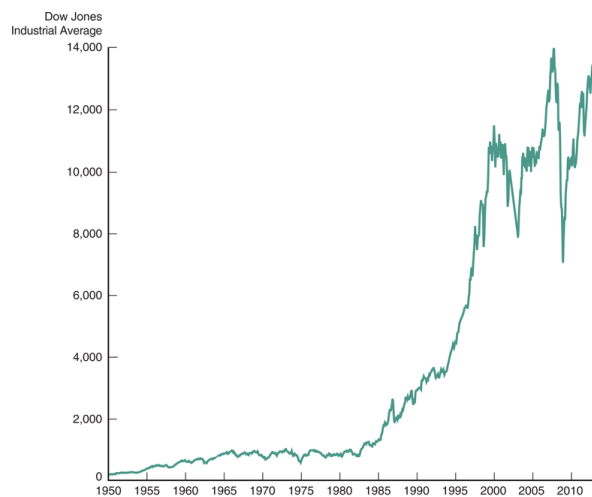
Why Study Financial Markets? The Stock Market

- The stock market is the market where common stock (or just stock) are traded.
- Companies initially sell stock (in the primary market) to raise money. After that, the stock is traded among investors.
- The stock market receives the most attention from the media.



Stock Market

Figure 1.2 Stock Prices as Measured by the Dow Jones Industrial Average, 1950–2013



Source: Federal Reserve Bank of St. Louis, FRED database: <http://research.stlouisfed.org/fred2/>.

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Why Study Financial Markets? The Stock Market

Companies, not just individuals, also watch the market.

- Often seeking additional funding
- The success of SEOs is dependent on the company's stock

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Why Study Financial Markets? The Stock Market

- In chapter 2, we will examine the role of the stock market in the financial system.
- In chapters 6 and 13, we will further look at how stock prices behave to information in the marketplace.



Why Study Financial Markets? The Foreign Exchange Market

- The foreign exchange market is where international currencies trade and exchange rates are set.
- Although most people know little about this market, it has a **daily** volume nearing \$3 trillion!



Foreign Exchange Market

Figure 1.3 Exchange Rate of the U.S. Dollar, 1970–2013



Source: Federal Reserve Bank of St. Louis, FRED database: <http://research.stlouisfed.org/fred2/>.

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Why Study Financial Markets? The Foreign Exchange Market

- These fluctuations matter!
 - In recent years, consumers have found that vacationing in Europe is expensive, due to a weakening dollar relative to the Euro.
 - When the dollar strengthens, foreign purchase of domestic goods falls.

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Why Study Financial Markets? The Foreign Exchange Market

In chapter 15, we will examine how exchange rates are determined in both the short- and long-run.



Why Study Financial Institutions?

We will also spend considerable time discussing financial institutions - the corporations, organizations, and networks that operate the so-called “marketplaces.” We will look at:

1. Structure of the Financial System
 - Helps funds move from savers to investors
2. Financial Crises
 - The “Great Recession” of 2007–2009 was the worst financial crisis since the Great Depression. Why did it happen?



Why Study Financial Institutions?

3. Central Banks and the Conduit of Monetary Policy
 - The role of the Fed, and foreign counterparts, in the management of interest rates and the money supply
4. The International Financial System
 - Capital flows between countries impacts domestic economies
 - Need to understand exchange rates, capital controls, and the role of agencies such as the IMF



Why Study Financial Institutions?

5. Banks and Other Financial Institutions
 - Includes the role of insurance companies, mutual funds, pension funds, etc.
6. Financial Innovation
 - Focusing on improvements in technology and the impact on financial product delivery
7. Managing Risk in Financial Institutions
 - Focusing on risk management in the financial institution



Applied Managerial Perspective

- Financial institutions are among the largest employers in the U.S. and often pay high salaries.
- Knowing how financial institutions are managed may help you better deal with them.



How We Study Financial Markets and Institutions

Basic Analytic Framework

1. Simplified models are constructed, explained, and then manipulated to illustrate various phenomena.
2. “Practicing Manager” cases are used to tie theoretical and empirical aspects.



How We Study Financial Markets and Institutions

Other features

1. Case studies
2. Applications and Numerical Examples
3. Special Interest Boxes
4. Hundred of analytical end-of-chapter problems
5. Predicting the Future problems



Exploring the Web

Web Exercise

The World Wide Web is an enormous resource for present and historical information. We will periodically present **web exercises** to introduce some of the important locations for information, and how to use it.



Exploring the Web

Web Exercise

The next three slides (starting on page 10 in the text) show you how to (1) find historical interest rates from the Fed and save the information, (2) how to import the data into Excel, and (3) how to examine the information using an Excel chart.



Exploring the Web

Figure 1.4 Federal Reserve Bank of St. Louis, FRED Database

To analyze interest rates, you must collect market interest-rate data. One metric commonly used is U.S. Treasury data. The Fed website maintains historical data on U.S. Treasury yields.

The screenshot shows the FRED database search results for '10-Year Treasury Constant Maturity Rate'. The page includes a search bar, navigation tabs, and a list of search results with filters for frequency and date range.

Series Name	Frequency	Date Range	Days Ago
10-Year Treasury Constant Maturity Rate	<input type="checkbox"/> Daily	1962-01-02 to 2013-07-11	(2 days ago)
	<input type="checkbox"/> Monthly	1953-04 to 2013-06	(6 days ago)
	<input type="checkbox"/> Weekly	1962-01-05 to 2013-07-05	(6 days ago)
10-Year Treasury Inflation-Indexed Security, Constant Maturity	<input type="checkbox"/> Daily	2003-01-02 to 2013-07-11	(2 days ago)
	<input type="checkbox"/> Monthly	2003-01 to 2013-06	(6 days ago)
	<input type="checkbox"/> Weekly	2003-01-03 to 2013-07-05	(6 days ago)

Source: <http://research.stlouisfed.org/fred2/>.



Exploring the Web

Figure 1.5 Excel Spreadsheet with Interest-Rate Data

Many websites are designed so that the data can be easily imported into Excel for further data analysis.

A	B	C	D	E
FRED Graph Observations				
Federal Reserve Economic Data				
Link: http://research.stlouisfed.org/fred2				
Help: http://research.stlouisfed.org/fred2/help-faq				
Economic Research Division				
Federal Reserve Bank of St. Louis				
GS10	10-Year Treasury Constant Maturity Rate (GS10), Percent, Monthly, Not Seasonally Adjusted			
DGS1	1-Year Treasury Constant Maturity Rate (DGS1), Percent, Monthly, Not Seasonally Adjusted			
Frequency: Monthly				
observation_date	GS10	DGS1		
2012-01-01	1.97	0.12		
2012-02-01	1.97	0.16		
2012-03-01	2.17	0.19		
2012-04-01	2.05	0.18		
2012-05-01	1.80	0.19		
2012-06-01	1.62	0.19		
2012-07-01	1.53	0.19		
2012-08-01	1.68	0.18		
2012-09-01	1.72	0.18		
2012-10-01	1.75	0.18		
2012-11-01	1.65	0.18		
2012-12-01	1.72	0.16		
2013-01-01	1.91	0.15		
2013-02-01	1.98	0.16		
2013-03-01	1.96	0.15		
2013-04-01	1.76	0.12		
2013-05-01	1.93	0.12		
2013-06-01	2.30	0.14		

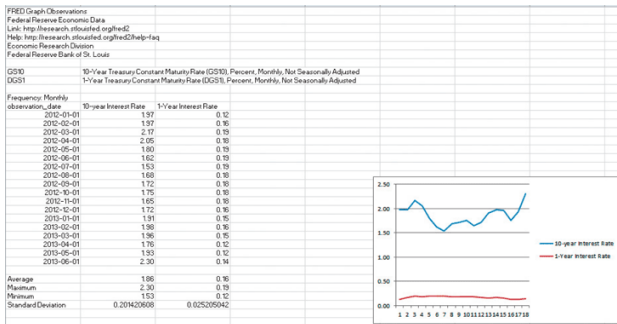
Source: Used with permission from Microsoft Corporation.



Exploring the Web

Powerful tools in spreadsheet programs allow you to graph data, run regressions, and conduct scenario analysis.

Figure 1.6 Excel Graph of Interest-Data



Source: Used with permission from Microsoft Corporation.



Concluding Remarks

- This field is an exciting one, and this book will help you develop skills to further your career and your understanding of financial events.
- You will also have a better understanding of the controversies to hotly debated in the political arena.



Chapter Summary

- Why Study Financial Markets?: the three primary markets (bond, stock, and foreign exchange) were briefly introduced.
- Why Study Financial Institutions?: the market, institutions, and key changes affecting these were outlined.



Chapter Summary (cont.)

- **Applied Managerial Perspective:** the book will often present material to better understand how actual managers use the information in daily operations.
- **How We Will Study Financial Markets and Institutions:** we outlines the three key components: analytical framework, features, and web exercises.