

NATIONAL UNIVERSITY OF SINGAPORE  
*NUS Business School*

**FIN 3116**  
**Options and Futures**

**Instructor:** Johan Sulaeman

Semester 1, 2015/2016

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Class Meetings: Tuesday, 11am-2pm / Friday, 1pm-4pm

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**Course Objective**

The objective of this course is to provide an in-depth analysis of financial derivative products: futures, swaps, and options. The analysis includes their valuation, trading strategies, and risk management. It should provide lasting conceptual framework in which to view the derivative markets and to examine new ideas, concepts, and instruments as they evolve in the future.

This course covers a great deal of advanced material. Students are expected to be comfortable with probability and statistics, the stock market, and a spreadsheet package such as Excel. Some use of stochastic calculus and differential equation will also be required.

After completing the course, you should be able to:

1. understand how financial derivatives are used by market participants,
2. understand how financial derivative values are calculated,
3. appreciate the pros and cons of the most widely used derivative pricing models,
4. identify mis-pricing in the derivative markets, and
5. understand practical considerations in constructing portfolios involving financial derivatives.

**Course Description**

This is a course in the theory and applications of financial derivative valuation. This course will present an in-depth analysis of financial derivative valuation, trading strategies for derivatives, and risk management of derivative positions. It will cover Black-Scholes and risk-neutral binomial pricing models. The main goal of the course is to become proficient in derivative value calculations and the implementation of derivative trading strategies.

Since the course emphasizes fundamental concepts underlying derivative valuation theory, the approach will be analytical and rigorous. The course employs homework assignments, classroom lectures and discussions, and computer-based assignments to convey the material. Some work will be done individually and some in groups. **Each student is expected to contribute regularly to classroom discussion.** This is particularly true when we discuss assignments, but also during lectures and general discussions.

The material for this course needs to be absorbed consistently. As the course progresses, students should work on the suggested homework problems to prepare for exams and assignments. All these problems are essential for a full understanding of the material covered in the course. You should find it helpful to read the assigned readings before we cover the material in class. In general, the difficulty of the material covered in class will be at least that of the textbook.

**Prerequisite**

Investment Analysis and Portfolio Management (FIN 3102).

**Course Material**

1. **Textbook:**

**Introduction to Derivatives and Risk Management, 10th Edition**

Don M. Chance and Robert Brooks

ISBN-10: 130510496X | ISBN-13: 9781305104969

2. **Financial calculator**

Each student is required to bring a calculator to all classes and the final exam. Any calculator that has an  $x^y$  button will do. Because of the variety of calculators used, students will be expected to learn how to use their calculators on their own.

3. **Class presentation slides** and **Excel spreadsheets** will be posted on the **course web page**.  
Please note that the material do not comprise self-contained lectures. Rather, the intent is to reduce the amount of rote copying so that more time can be devoted class discussion.
4. **Notes and articles** from academic finance journals and periodicals (WSJ, Economist, etc.) will be either handed out in class or linked **directly to the web page**.
5. Computer-based **project** assignments (see below).
6. **Textbook problems**.  
Suggested textbook problems will be made available; some will be included as homework assignments. You are responsible for understanding all suggested problems (including those that are not part of the graded assignments) since they will help prepare you for projects and tests. Solutions provided by the publishers will be posted on the course website.

### Course WebPage

Various course material will be distributed through this website: **TBA**  
We will use **Piazza** for class discussion. Rather than emailing questions to me, I encourage you to post your questions on Piazza so that you can get help fast and efficiently from your classmates and me.

Website: <http://piazza.com/> (also available as iOS and Android mobile apps)

### Student Assessment

The course grade will be based on the following:

Homeworks	5 %
Project 1: <b>TBA</b> (due and presented on <b>Week 8</b> )	15 %
Project 2: <b>TBA</b> (due and presented on <b>Week 12</b> )	15 %
Quiz 1 ( <b>Week 6</b> )	30 %
Quiz 2 ( <b>Week 13</b> )	30 %
Class Participation and Citizenship	<u>5 %</u>
<b>Total</b>	<b>100 %</b>

Letter grades will be assigned based on the class distribution of the course's total scores. The grade cutoff points will be adjusted based on the class's overall performance.

### Homework

You will be asked to do and submit a series of homework assignments. At two points in the term (weeks 6 and 12), I will grade one randomly selected homework assignment. Failure to turn in a homework assignment (even one which is not eventually graded) by its deadline will result in a zero grade.

### Projects

Each project report may be prepared by teams of four or five participants (individual submissions are not recommended). Your objective is to answer the questions posted for each project assignment on the Course Materials webpage. Each team member will receive the same grade. While each group will submit only one report for the group, **all students must come fully prepared to present their solution to the rest of the class**. Project reports should be submitted to the instructor by **3pm on the due date**.

All groups must come to class prepared to present their solution. You should bring the presentation slide deck (PowerPoint or otherwise) in a USB thumb drive, and email the presentation file to the instructor before the class session. **I will randomly select some groups to present their work**. The whole group will be penalized if the presentation is longer than 10 minutes, is unclear, or does not match the group's project report. The lecturer may interrupt the presentation to clarify certain issues or correct contents in the interest of the class. As I may randomly select a group member to present the group's slide deck, I highly recommend each group member to practice the presentation to improve clarity and ensure that they meet the time constraint.

Grading will be based on the accuracy of the analytical analysis (60%) and on exposition and presentation of findings (40%; this includes the classroom presentation component above). The reports should not exceed **four** double-spaced pages of text; the intent of the page limitation is to enforce careful writing. The four-page limitation does not include figures and exhibits; please include those as you deem necessary to convince (but not confuse) the reader. Your response should be consistent with and supported by your main analysis.

I will conduct a group evaluation survey after each project report is submitted. Please keep track on how your teammates contribute to the report and how your team functions as a whole.

### Quizzes

There will be two quizzes (weeks 6 and 13). The quiz format will likely be a combination of multiple-choice and true-false questions, extensive numerical problems, and essay-type questions. These questions will be designed to test your analytical and problem solving skills, and your knowledge of conceptual and qualitative material. The **second quiz** will be cumulative but will emphasize topics covered after the **first quiz**. If, for some valid and documented reason, you are unable to take the first quiz on the scheduled date, then the weighting of the grade on the first quiz will be transferred to the second quiz. Students must take the second quiz to receive a passing grade for this module.

### Class Participation and Citizenship

I will observe student participation in the course and reward those students who make a substantial effort. Simply attending the class is a necessary condition, but **not enough** to get a favorable class participation grade. In evaluating class participation, I will look for comments that are thoughtful and lead the discussion forward. My evaluation will be based on how well you have participated in class, looking at the quality, not the quantity, of your participation. You can improve your participation grade considerably by coming to class prepared. Points awarded are **at my discretion** and are based solely on **my opinion** of your efforts and your contribution to class discussions. These points are not automatically given, but must be earned. They are **not subject to negotiation**.

### Contacts

I highly recommend contacting me through email. In general, you can stop by my office anytime. In the event that you come to my office without an appointment, I reserve the right to ask you to come back some other time or even some other days. In order to ensure that I am available for consultation, I recommend that you send me an email to arrange an appointment.

As mentioned above, I encourage you to post your questions on Piazza so that you can get help fast and efficiently from your classmates and the instructor.

### Class Policies

#### 1. **Academic Honesty & Plagiarism**

I will strictly enforce the university rules on academic integrity.

- Academic integrity and honesty is essential for the pursuit and acquisition of knowledge. The University and School expect every student to uphold academic integrity & honesty at all times. Academic dishonesty is any misrepresentation with the intent to deceive, or failure to acknowledge the source, or falsification of information, or inaccuracy of statements, or cheating at examinations/tests, or inappropriate use of resources.
- Plagiarism is 'the practice of taking someone else's work or ideas and passing them off as one's own' (The New Oxford Dictionary of English). The University and School will not condone plagiarism. Students should adopt this rule - You have the obligation to make clear to the assessor which is your own work, and which is the work of others. Otherwise, your assessor is entitled to assume that everything being presented for assessment is being presented as entirely your own work. This is a minimum standard. In case of any doubts, you should consult your instructor.
- Additional guidance is available at:  
<http://www.nus.edu.sg/registrar/adminpolicy/acceptance.html#NUSCodeofStudentConduct>
- Online Module on Plagiarism: <http://emodule.nus.edu.sg/ac/>

#### 2. **Attendance**

Our class discussions will go beyond the scope of the textbook for most topics. Therefore, it is important for you to attend class. You are responsible for all announcements made in class. If you are unable to attend a particular class, please notify the professor of your absence *prior* to that class. Failure to notify the professor of absence, or missing more than two sessions during the course, might result in a failing grade. For an excused absence, the make-up for missed work will be determined by the professor in consultation with the student.

### 3. Laptop, Tablets, PDAs, Phones

Please be respectful of others in your usage of electronic devices and wireless communication. By taking this class, you agree to ` Students are bound by the following policies:

- Mobile phones and smart-phones: they need to be shut off or set to silent mode during class session. No telephone calls, SMS/MMS messages, or e-mails during class. Phones must be completely turned off during class time. Upon violation of this policy, you must put your mobile device on the table in **off** mode and **FACE DOWN**. You might also be asked to deposit your devices in a designated area in the classroom.
- Laptops and tablets: Laptop and tablet use is restricted to note-taking use only. The use of these devices for chat sessions, checking/answering e-mails, and web surfing is prohibited. I will announce exceptions to the policy for class sessions with course-related content on the web.
- Violation of the policies can lower the class citizenship component of course grade above.

## Tentative Course Schedule (Subject to Change)

This is an approximate schedule of topics that will be covered. The assigned readings will provide the framework for classroom discussions. All readings are required; please read them **prior** to the corresponding lecture. Recommended reading will be assigned throughout the course.

Week	Date	Topic	Reading
1	Aug 11/14	<b>Introduction; Mechanics of Derivative Markets</b>	CB, Chapter 1 (Introduction) CB, Chapter 2 (Structure of Derivatives Market)  <b>HW: Ch. 2</b>
2	Aug 18/21	<b>Pricing Forwards and Futures</b>	CB, Chapter 8-1, 8-2, 8-3 (Carry Arbitrage, Pricing Models)  <b>HW: Ch. 8 (part 1)</b>
3	Aug 25/28	<b>Hedging using Futures</b>	CB, Chapter 9 CB, Chapter 10  <b>HW: Ch. 9-10</b>
4	Sep 1/4	<b>Interest Rates Futures and Forwards (FRA)</b>	CB, Chapter 12-1 (Forward Rate Agreements)  <b>HW: Ch. 12 (part 1)</b>
5	Sep 8/11	<b>Swaps</b>	CB, Chapter 11  <b>HW: Ch. 11</b>
6	Sep 15/18	<b>***** Quiz 1 *****</b>	
<b>RECESS WEEK</b>			
7	Sep 29 / Oct 2	<b>Properties of Options; Mechanics of Option Markets</b>	CB, Chapter 3  <b>HW: Ch. 3</b>
8	Oct 6/9	<b>Pricing Stock Options: Binomial</b>  <b>PROJECT DUE:</b> <b>TBA</b>	CB, Chapter 4  <b>HW: Ch. 4</b>
9	Oct 13/16	<b>Pricing Stock Options: Black-Scholes</b>	CB, Chapter 5  <b>HW: Ch. 5</b>
10	Oct 20/23	<b>Option Trading and Hedging Strategies</b>	CB, Chapter 6 CB, Chapter 7  <b>HW: Ch. 6</b>
11	Oct 27/30	<b>Changing Underlying Assets; Interest Rates Options</b>	CB, Chapter 12-2, 12-3 (Interest Rate Options, Interest Rate Swaptions) CB, Chapter 8-4 (Pricing Options on Futures) Reading: "Options on Stock Indexes, Currencies, and Futures"  <b>HW: Ch. 8 (part 2), Ch. 12 (part 2)</b>
12	Nov 3/6	<b>Exotics</b>  <b>PROJECT DUE:</b> <b>TBA</b>	CB, Chapter 13  <b>HW: Ch. 13</b>
13	<b>TBA</b>	<b>***** Quiz 2 *****</b>	