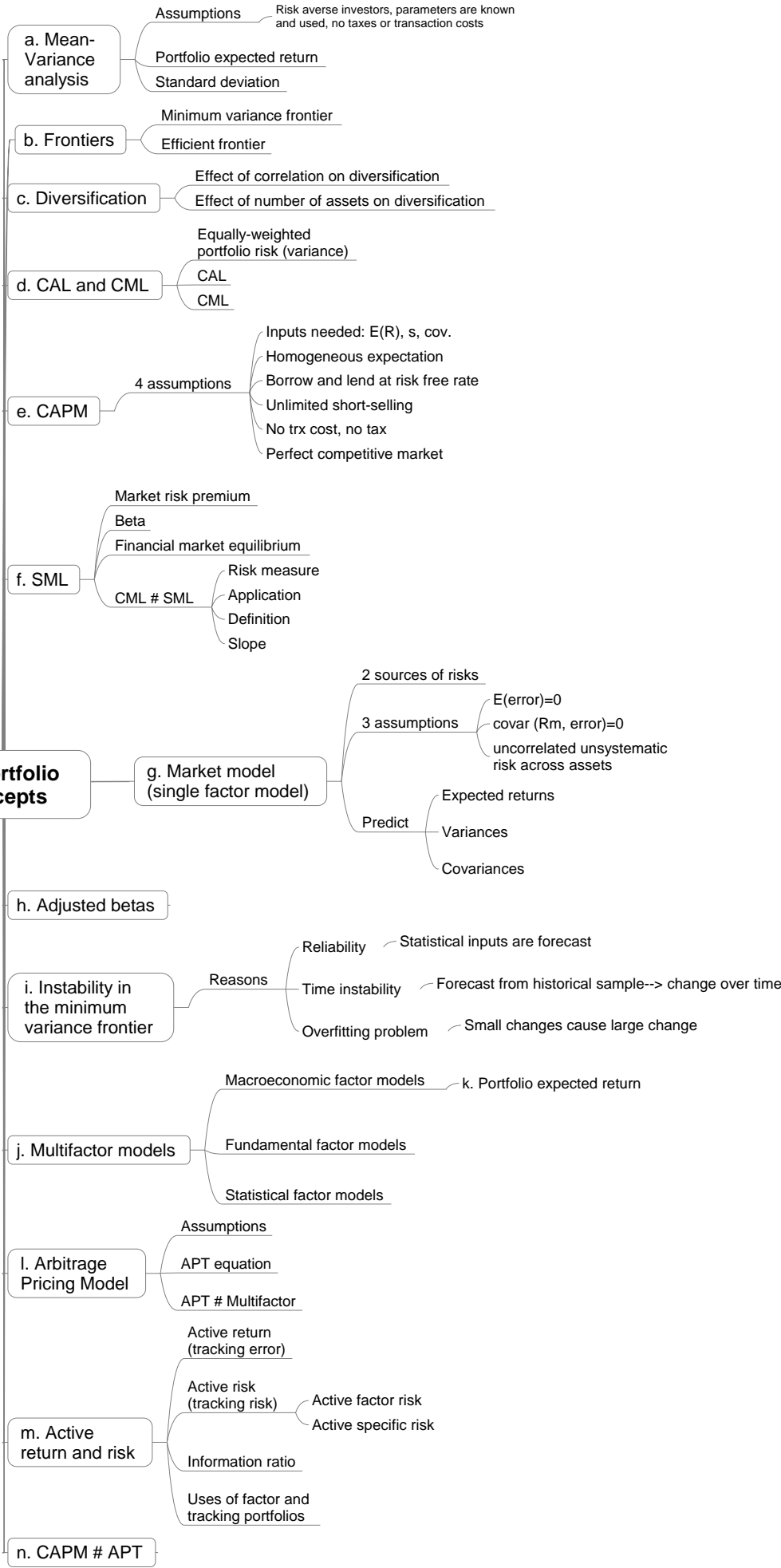
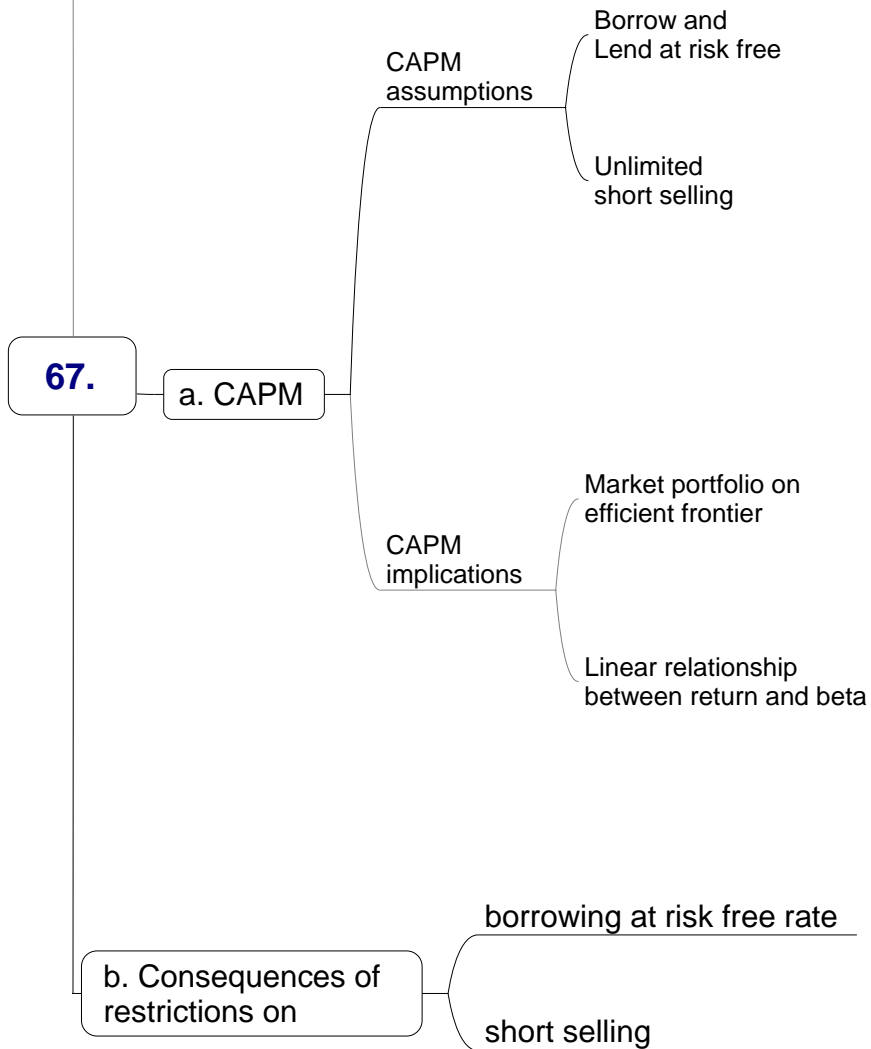
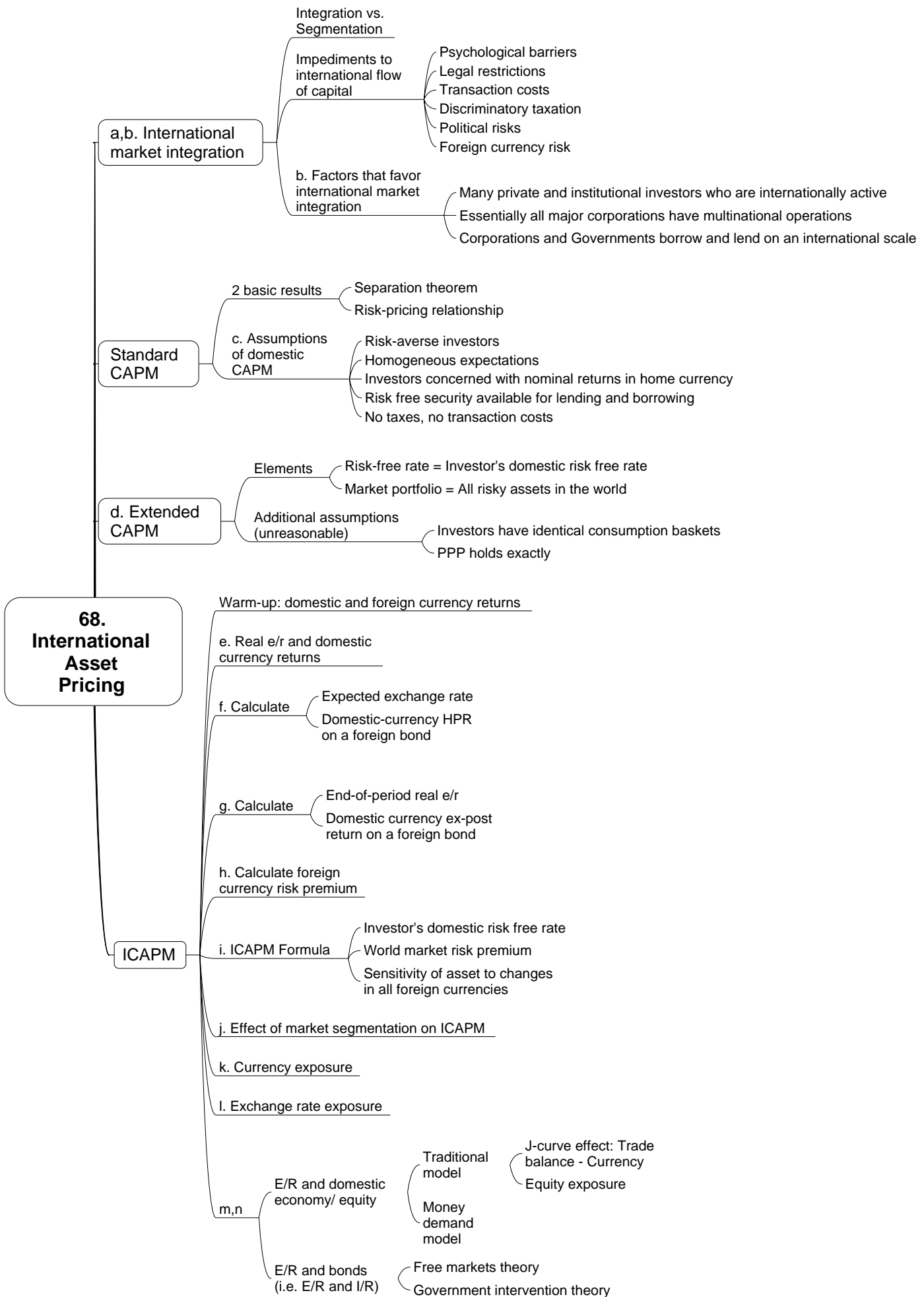


66. Portfolio Concepts



67. A Note on Harry M. Markowitz's "Market efficiency: a theoretical distinction and so what?"





a,b. International market integration

Integration vs. Segmentation

Impediments to international flow of capital

- Psychological barriers
- Legal restrictions
- Transaction costs
- Discriminatory taxation
- Political risks
- Foreign currency risk

b. Factors that favor international market integration

- Many private and institutional investors who are internationally active
- Essentially all major corporations have multinational operations
- Corporations and Governments borrow and lend on an international scale

Standard CAPM

2 basic results

- Separation theorem
- Risk-pricing relationship

c. Assumptions of domestic CAPM

- Risk-averse investors
- Homogeneous expectations
- Investors concerned with nominal returns in home currency
- Risk free security available for lending and borrowing
- No taxes, no transaction costs

d. Extended CAPM

Elements

- Risk-free rate = Investor's domestic risk free rate
- Market portfolio = All risky assets in the world

Additional assumptions (unreasonable)

- Investors have identical consumption baskets
- PPP holds exactly

68. International Asset Pricing

Warm-up: domestic and foreign currency returns

e. Real e/r and domestic currency returns

f. Calculate

- Expected exchange rate
- Domestic-currency HPR on a foreign bond

g. Calculate

- End-of-period real e/r
- Domestic currency ex-post return on a foreign bond

h. Calculate foreign currency risk premium

ICAPM

i. ICAPM Formula

- Investor's domestic risk free rate
- World market risk premium
- Sensitivity of asset to changes in all foreign currencies

j. Effect of market segmentation on ICAPM

k. Currency exposure

l. Exchange rate exposure

m,n

E/R and domestic economy/ equity

- Traditional model
- Money demand model

- J-curve effect: Trade balance - Currency
- Equity exposure

E/R and bonds (i.e. E/R and I/R)

- Free markets theory
- Government intervention theory

