

Overview of Markets

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Financial decisions within firm

Financing

Investments

Payout

What do these decisions look like for different types of firms?

- Think of a proprietorship: single owner
- Eventually, that firm may need external sources of financing
 - Bank loan
 - Other sources (e.g., private equity)
 - Public equity and bond markets
- Trade-offs?
 - Firm should consider costs vs. benefits
 - These factors (e.g., access to capital markets and specialization) vary with type of firm or with time

Public markets

- Think about making a 'good' investment decision
 - Who gets the incremental value?
 - Firm as a line of claimants

- What are the priority rules?
 - Equity holders are residual claimant

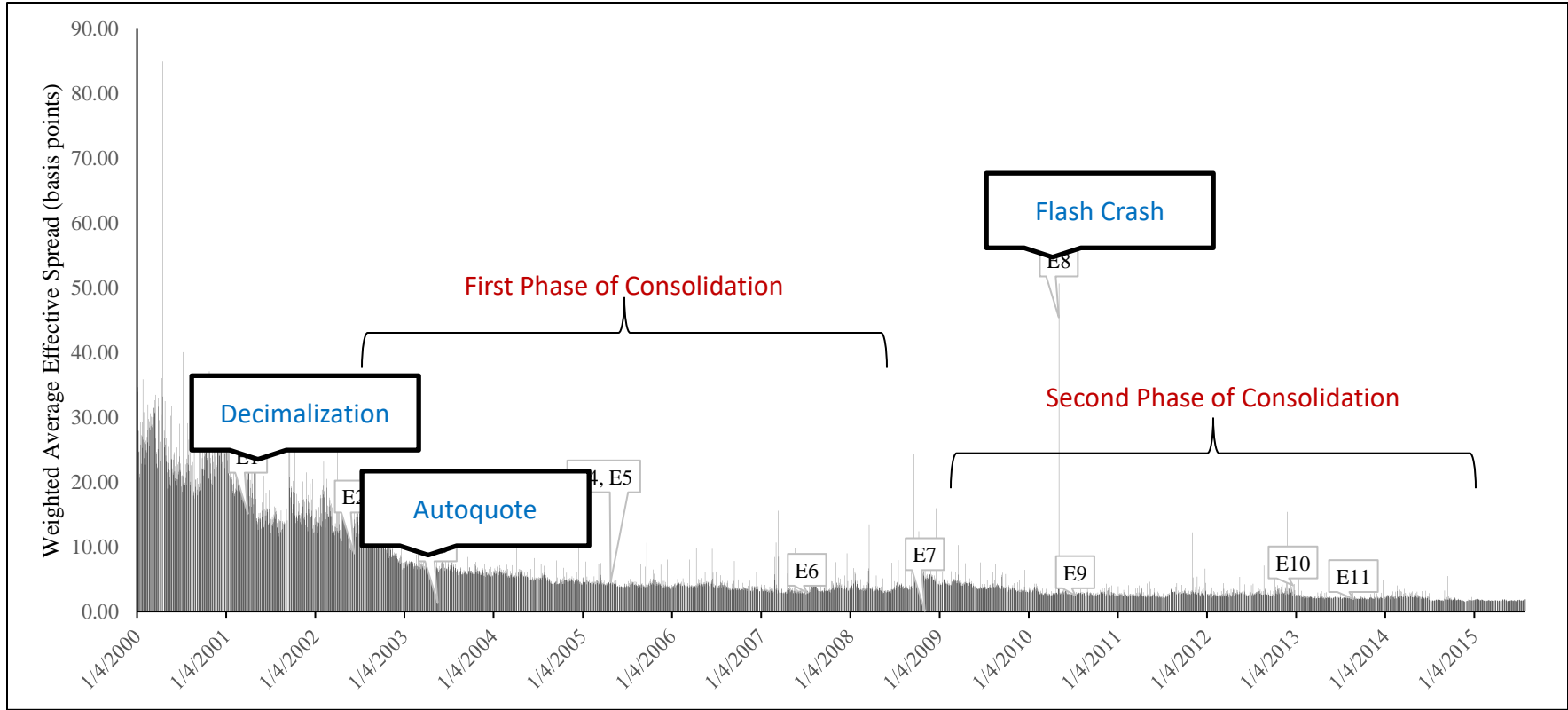
Public markets: Equity

- What are the functions of this market?
 - To clear the market at t
 - Market microstructure digression
 - To price the asset
 - What matters?
 - Cash flows
 - Discount rates

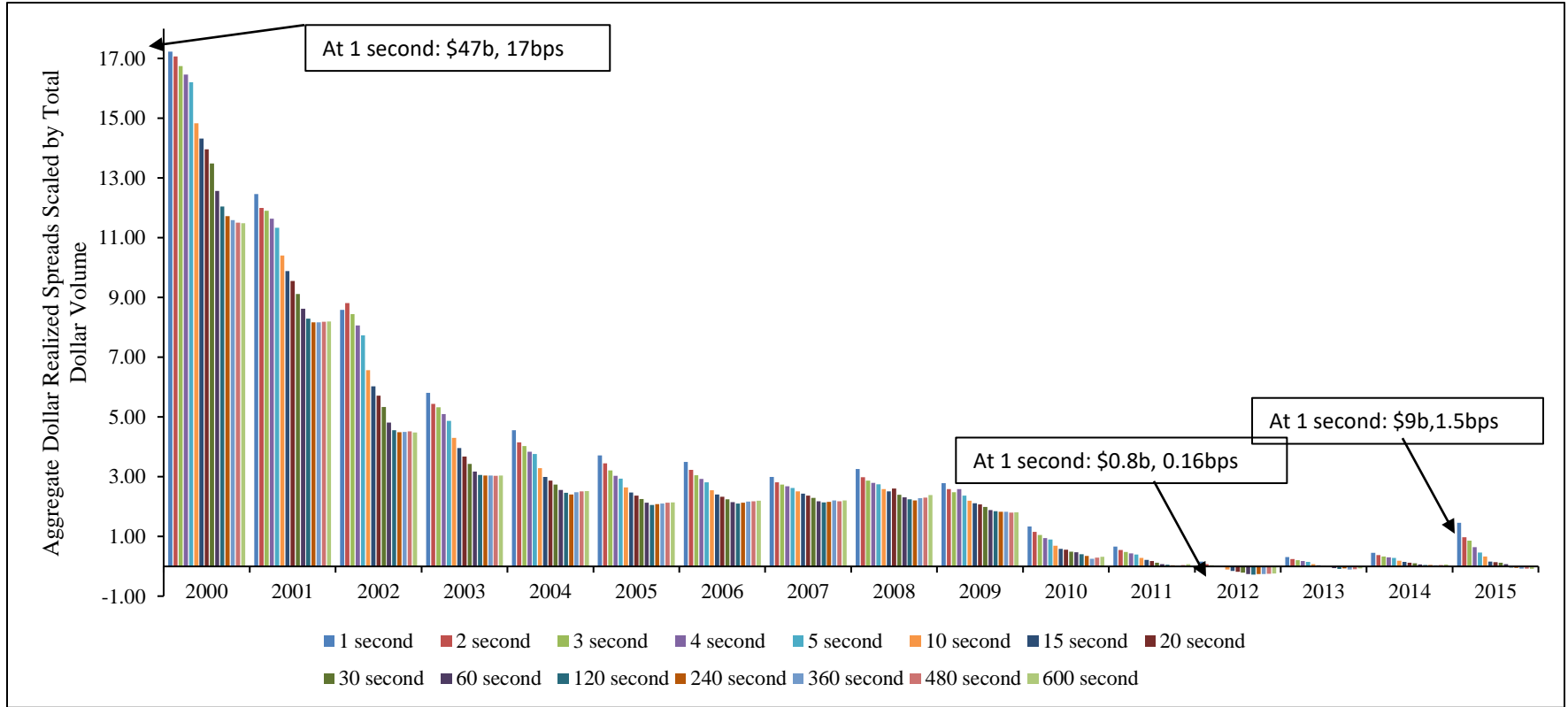
Public markets: Equity

- How does the market do at these tasks?
- Let's look at trading costs first

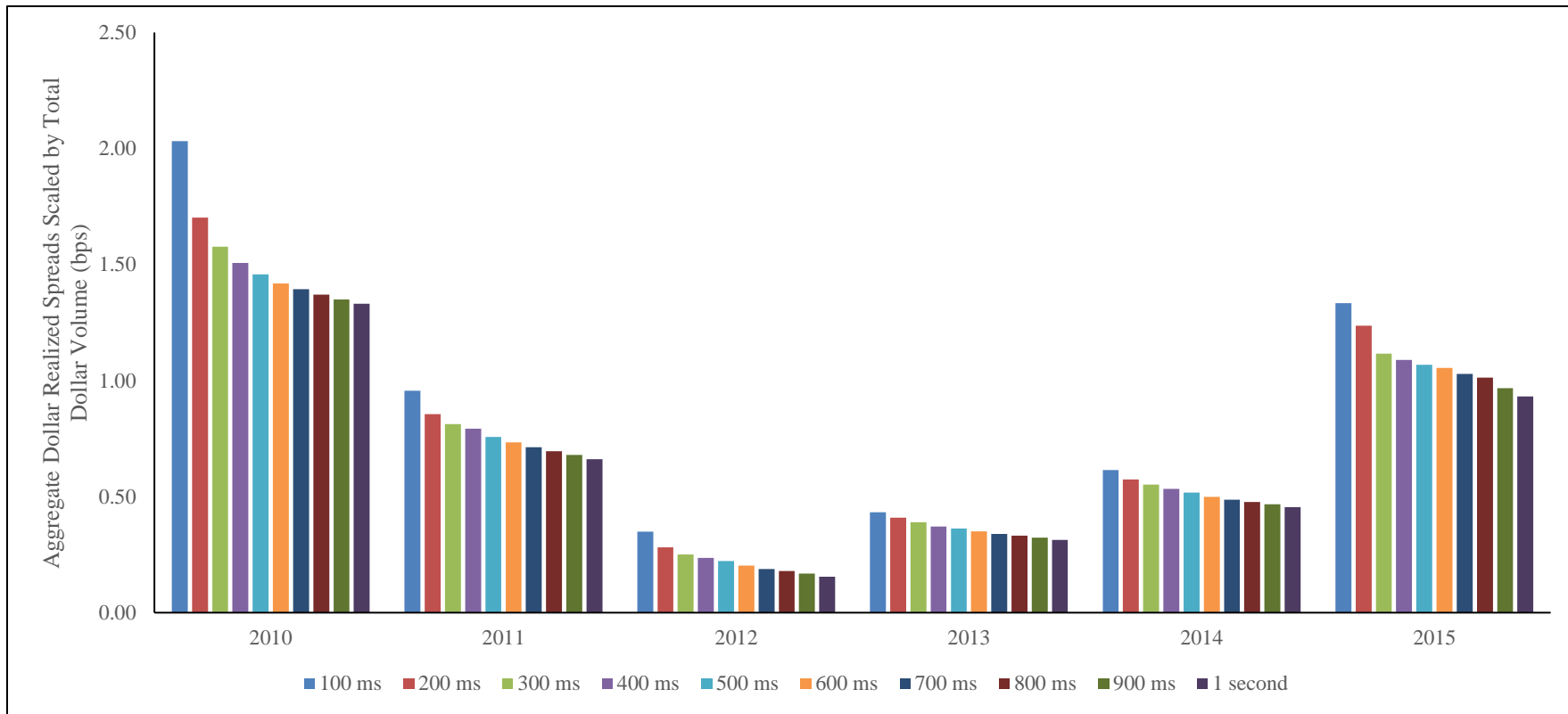
Aggregate Effective Spreads



Aggregate Realized Spreads



Aggregate Realized Spreads: Zoom



Public markets: Equity

- How does the market do at these tasks?
- How well does it do at pricing?
 - Market efficiency debate
 - *Brief* overview +take-aways
 - What should one consider when investing?
 - Risk preferences
 - Diversification
 - Information sources

One last thing: Options

- What are options?
- How are they valued?
- How can they be used?
- Why would we be interested in them?
- What should we be worried about?

Conclusion

- Equity market, in particular, has become more liquid in last two decades
- Empirical evidence to date suggests that it is difficult to reliably earn excess return based on public information
- On average, equity markets have earned risk premium to compensate for volatility
 - Structural changes going forward?
- Market efficiency as a framework