University of Amsterdam

Financial Markets

Coursework III

Please note that in order to respond to question 5 you will have to collect a trading system on Wednesday October 5th, from 9.00 -13.00 from Philip Prompers on the E building 4th floor. If any of the members of the group is able to be there then you can send someone a written authorisation signed by all member of the group including the reason of your unavailability. Please be aware that a signature is required and only one trading system per person will be given.

1. **Liquidity & The Black Swan**

   In 2007 Nasim Taleb published The Black Swan: The Impact of the Highly Improbable, which catalog him as one of the hottest thinker in the world. While the book became a "must read" among financiers and wannabes, among the scientific community and especially finance academics a big dosses of scepticism appears against his theory.

   - explain in Layman terms Taleb's black swan theory
   - critically assess Taleb Theory as mass phenomena Vs academic relevance of his reserach

2. **Crashophobia**

   Explain what is meant by crashophobia and its relevance for globalised markets?

3. **Volatility**

   Suppose that the daily volatility of the FTSE 100 stock index (measured in pounds sterling) is 1.8% and the daily volatility of the dollar/sterling exchange rate is 0.9%. Suppose further that the correlation between the FTSE 100 and the dollar/sterling exchange rate is 0.4.

   - What is the volatility of the FTSE 100 when it is translated to U.S. dollars? Hint: Assume that the dollar/sterling exchange rate is expressed as the number of U.S. dollars per pound sterling.
   - Why does it matter?

4. **Observed Prices & Volatility**

   Explain from a quantitative point of view (i.e. in statistical terms) the difference between an unusual and abnormal observed price and why does it matter in financial markets?

5. **Trading system**

   (a) Test the trading system given to you on the Singapore Stock exchange for the period Jan 2009- September 2009

   (b) Choose your starting date and remember your trading horizon is only 3 months. After 3 month all trades will be cancelled and positions netted

   (c) your initial capital is of 100 000

   (d) you can only make the first 32 transactions commission free , all the rest of the transactions have a cost of 1% per transaction

   (e) you are free to add all instructions missing and/or amend all of them you consider wrong, nevertheless all changes should be explained on your assessment report (see below)

   (f) write a 500 words report about your experience with the system specifying strengths and weaknesses

   (g) Compare your performance using the trading system with the following returns for the same period:

   - MCSI Emerging Markets
   - IPD (UK)
   - Case-Schiller (US)