Reading Guide – Chapter 7 – Financial Markets

Not for Points, Quiz At the end of class Monday 9/29 10 pts.

**148-160**

Key Concepts:

All financial instruments do the these 4 things: 1) Raising Capital 2) Storing, Protecting, and Making Profitable Use of Excess Capital 3) Insuring Against Risk 4) Speculation – Make sure that you understand each of these.

1. What does it mean to “raise capital”? Why is this important within the economy? (150-151)
2. What is “excess capital”? What is the role of financial instruments in putting excess capital to use?

How does this work? (151-152)

1. What is risk? What role does insurance play in negotiating risk? (152-153)
2. There are other financial instruments that deal with the issue of risk. What are futures contracts? What are catastrophe bonds? (154-155)
3. What is a credit default swap? (156-157)
4. What does it mean to “speculate”? (157)
5. Try to explain how credit default swaps contributed to the financial crisis. This is a tough one. (157-158)
6. The author tries to argue that Wall Street is better than Las Vegas. Explain his argument. (158-159)
7. How can the government get involved in the financial markets? (159)

**160-174**

Terms: mutual fund index fund 401(k)

Concepts:

1. Read the author’s example of the house situation as he tries to explain how people make money in the financial markets. (160-161) Why is this story wrong ? (161-162)
2. How does the “efficient markets theory” play a role in how the financial markets work? (163)
3. How is investing (buying stocks, etc.) like a line at the grocery store? (163-164)
4. Do think the joke about the economists and the $100 bill is funny? (165)
5. What other factors in how people invest challenge the efficient markets theory? In other words, why doesn’t the efficient markets theory explain fully how market work? (165-166)
6. Explain these pieces of investing advice from the author:

Save, Invest, Repeat (168-169)

Take risk, earn reward (169-170)

Diversify (171-172)

Invest for the long run (172-173)