TEACHING FINANCIAL MARKETS USING THE WALL STREET JOURNAL

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ABSTRACT

This note describes how the Wall Street Journal can be employed as a substitute for a textbook in an M.B.A. course on money and capital markets. The typical textbook is two years out of date by the time it reaches the classroom. Rapid change in the financial markets renders the traditional textbook effectively obsolete. The Wall Street Journal provides a potential solution to this problem.

INTRODUCTION

The financial markets are an arena that has been changing very rapidly in recent years. Rapid consolidation along industry lines among banks, securities firms, and insurance companies has become the norm in the United States. This trend toward larger firms will undoubtedly be augmented in the next few years in response to the repeal, enacted in 1999, of the provisions of the Glass-Steagall and Bank Holding Company Acts that previously served to separate firms engaged in the businesses of banking, securities, and insurance. The elimination of these cross-industry barriers among financial firms will lead to further consolidation. The creation of Citigroup through the merger of Citicorp and Travelers is an early example of such consolidation.

Innovations in financial theory and telecommunications technology, coupled with significant deregulation, have revolutionized the world of finance in the last quarter century, which has witnessed the introduction and rapid growth of many different kinds of derivative securities and tools for risk management. Middle-class American households have had to become sophisticated in financial matters just to manage their personal finances. Their world is a very different one from that of their parents, for whom bank accounts and life insurance represented the vast bulk of their financial wealth.

Against this backdrop, the usefulness of traditional textbooks in courses on the financial markets has declined substantially. The problem is that the lag involved in composing, producing, and distributing a textbook virtually guarantees that the data presented will be at least two years old by the time that students get to use the book. That is simply inadequate in the present financial environment.

To deal with this fundamental pedagogical problem, I have developed over the last ten years a curriculum for the M.B.A. course on money and capital markets that substitutes the Wall Street Journal for the traditional textbook.

CLASSROOM ACTIVITY

I devote part of the first weekly meeting of my course on the financial markets to the importance of the Wall Street Journal as a learning tool. I require the students to read the Wall Street Journal regularly, with emphasis on the third section of the newspaper, which is called “Money and Investing.” This is the section of the paper that provides news from the financial markets, including the results of the previous business day’s trading in the major securities markets of the world. In my experience most of the students choose to enter subscriptions to receive the paper on a daily basis, rather than rely on the library’s copy.

I devote the second weekly meeting of the course to a single topic, “How to read the Wall Street Journal.” The students spend approximately two hours becoming acquainted with such daily features and columns as “Abreast of the Market” and “Heard on the Street.” They learn how to read stock and bond quotations. With the aid of the “Markets Diary,” they learn about the major market indexes and how they are constructed. They learn where in the paper to look for such important tools as the U.S. Treasury yield curve. The role of the instructor needs to reflect the students’ previous finance training (or the lack thereof).

Beginning in the third week of the course, at least half of the classroom time is spent learning about the world of finance through the pages of that day’s Wall Street Journal. Each student is required to come to class with a copy of that day’s Wall Street Journal. I ask them to spend at least twenty minutes reading the paper prior to the beginning of the class.

Over the course of the semester the Wall Street Journal becomes a vehicle for exploring both the financial markets themselves and the financial institutions that operate in them. There is not one substantive area or principle of the money and capital markets that cannot be taught effectively using the Wall Street Journal. It is practically made to order to illustrate and explain how the various financial markets relate to one another. Concepts like “equilibrium” and “arbitrage” take on real meaning. The purposes and roles of various networks of financial firms are illustrated in the articles, columns, and even the advertisements.

The instructor needs to be flexible enough to take advantage of major news stories, as they appear in order to
introduce and develop substantive concepts. This requirement means that the instructor should be willing to develop topics out of the normal course sequence when the opportunity arises.

LEARNING OBJECTIVES

Over the course of the semester, students develop an ability to think like investors. They observe the role of “fads” in influencing the activities of commercial and investment bankers. They observe links between incentives and behavior. They learn to use the theory of the term structure of interest rates to interpret the information content of the Treasury yield curve. They come to appreciate the volatile ways of the stock markets of the world. By the end of the semester they have even begun to read between the lines. They discover that much conventional thinking in finance, duly reported in the pages of the Wall Street Journal, simply does not make sense. For example, the staff reporters of the newspaper often quote market participants who explain movements in stock prices as caused by investors putting money into, or taking money out of, stocks. But that is impossible. The students come to observe enough transactions in the financial markets to appreciate the fact that money cannot go into stocks and stay there. The reason is that transactions require both a buyer and a seller. Thus the money going “in” is equal to the amount of money coming “out” at the same time (neglecting transaction costs). It is only a small further step for them to understand why securities prices can change (and often do) without any transactions taking place.