Asymmetric information in financial markets
Spring 2015
UNC at Chapel Hill

1 General information

By keeping this handout you can remember all this important information:

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2 About the course

This course will discuss some basic ideas around the effects of asymmetric information in financial markets. Note that the amount of lecture time, and the number of credits of the course, will only allow us to scratch the surface of the main topics. Nonetheless I shall try to give you not only foundations, but also some applications of the models, just so you see how people may use theory in the real world.

Grading: homework 30%, final exam 50%, class participation 20%. We shall announce the due date for the homeworks as well as the date for the final exam via the course webpage. Also note how class participation is an important part of the course grade.

Lastly, but probably most importantly, I encourage you to use email as the main way to communicate, in terms of questions on the lectures or the assignments. Also, please visit the class webpage, since there you will have access to all the course materials.

The prerequisite for this course is a one-year course in asset pricing theory, i.e. familiarity with Huang and Litzenberger, Foundations for Financial Economics (North-Holland, 1988). Some graduate-level knowledge of microeconomics and statistics will also be useful.

3 Course Material

There is no required textbook for this course. Some highly recommended textbooks are:


The following books and survey articles may also be useful:


• Harris, Larry, 2003, Trading and Exchanges Market Microstructure for Practitioners, Oxford University Press.


Other books relevant for research in the information/finance world:

• Dark Markets, by Duffie.


• The Analytics of Uncertainty and Information, by Hirshleifer and Riley.

• Rational Herds, by Chamley.

• Game Theory, by Fundenberg and Tirole.

We will not follow any of the above books closely, but each gives a different perspective on the microstructure field, and I encourage you to browse through them.

4 Topics and outline

The following is a tentative outline of the course.

I. Preliminaries

Introduction to market microstructure topics. Bilateral trade with asymmetric information. Review of Bayesian updating and asset pricing with CARA utility.

Chapter 23 from MasCollel, Whinston and Green (1995).

II. Competitive models


Key papers:

Other fun papers:

III. Strategic trading


Key papers:

Applied/related work:
IV. Bid-ask spreads

We will continue the course by discussing two strategic models of price formation: that of Glosen and Milgrom (1985) and that of Easley and O’Hara (1987).


Related work:

V. Current topics

We will finish the course by discussing current topics in research in the area of informational economics.


VI. Major omissions

The course is too heavy on García papers, but I take my agency models very seriously. One huge area that I am mostly ignoring when I teach this course is dynamic models. The other is empirical topics. No effort to work on the later, but below are some papers on dynamic asset pricing with asymmetric information.


Note: the main source of material for this course is the class notes that I provide in the class webpage. Reading through the original research papers is also a must.