Master of Arts Examination 2018

(2^{nd} Year 3^{rd} Semester)

Economics

Financial Economics
(Old Syllabus)

Answer any three

Time: 2 Hours **Full Marks: 30**

1. (a) What do you mean by short-term solvency of a firm? What indicators are used to evaluate short-term solvency of a firm? Explain them with the help of numerical illustrations.
   (b) How is the market value of a firm is assessed? [(1+5) + 4]

2. (a) What do you mean by an efficient capital market?
   (b) Explain the three forms of market efficiency. (3+7)

3. (a) Why an efficient frontier cannot have a dent?
   (b) Discuss why the concepts of covariance and diversification are closely related.
   (c) Dode Brinker owns a portfolio of two securities with the following expected returns, standard deviations and weights:

Security	Expected Return	Standard Deviation	Weight
A	10%	20%	0.35
B	15%	25%	0.65

   For varying levels of correlation between the two securities, what is the maximum portfolio standard deviation? What is the minimum?
   (4+3+3)

4. (a) Calculate the internal rate of return of a project with the following cash flows:

Year	0	1	2	3	4
Cash Flows	(100,000)	30,000	30,000	40,000	45,000

   (b) Show with the help of a numerical example that the payback period as an investment criterion ignores cash flows beyond the payback period. (6+4)

[Turn over

5. (a) The following information is available for Avanti Corporation:

- Earnings per share: Rs. 4.00
- Rate of return of investments: 18%
- Rate of return required by shareholders: 15%

What will be the price per share as per the Walter model if the payout ratio is (i) 40%, or (ii) 50%, or (iii) 60%?

(b) The following information is available about Kavita Musicals:

- Earnings per share: Rs. 5.00
- Rate of return required by the shareholders: 16%

Assuming that the Gordon valuation model holds, what rate of return should be earned on investments to ensure that the market price is Rs. 50/- when the dividend payout ratio is 40%?

(c) State the traditional position on the relationship between dividend policy and share valuation.

(4+3+3)