

Master of Arts Examination 2017
(2nd Year 3rd Semester)
Economics
Financial Economics

Answer any three

Time : 2 Hours

Full marks ; 30

1.

a) Clapper Corp. issued 12 year bonds 2 years ago at a coupon rate of 7.8 %.The bonds make semi-annual payments. If these bonds currently sell for 108 % of par value, what is the YTM?

b) Cannone Corporation will pay a \$ 4.00 per share dividend next year. The company pledges to increase its dividend by 4 % per year indefinitely. If you require a 13% return on your investment, how much will you pay for the company's stock today ?

c) The going rate on student loans is quoted as 8% APR. The terms of the loan call for monthly payments. What is the EAR on such a loan?

5+5

2.

a) Tick the correct answer and explain briefly

Optimal capital structure of a firm is one

- I. where the firm's debt-equity ratio is one
- II. that just balances the additional gain from leverage against the additional financial distress cost
- III. when weighted average cost of capital is zero

Homemade leverage is

- I. the use of corporate borrowing to purchase additional shares by the existing shareholders
- II. the use of personal borrowing to change the overall amount of financial leverage to which the individual is exposed.
- III. the use of corporate borrowing for the R&D of the firm

b) How would you relate NPV and IRR rule of capital budgeting?

c) Linkin Park Corporation is comparing two different capital structures, an all-equity plan (Plan I) and a levered plan (Plan II). Under Plan I, Linkin Park would have 100,000 shares of stock outstanding, Under Plan II there would be 50,000 shares of stock outstanding and \$ 1.5 million in debt outstanding. The interest rate on debt is 10 percent and there are no taxes. Using M & M Proposition I, find the price per share of equity under each of the two proposed plans.

3+2+5

[Turn over

3.

a) Suppose the risk-free rate is 8 %. The expected return on the market is 16 %. If a particular stock has a beta of 0.7 ,what is the expected return based on CAPM? If another stock has an expected return of 24 % what must the beta be?

b) "If an investor is assumed to use riskless lending and borrowing in his investment activity, the shape of the efficient frontier transforms into a straight line. " Explain the above statement

c) Discuss how the risk –return relationships are depicted by Capital Market Line and Security Market Line.

4+2+4

4.

a) . What do you mean by 'short position'? How does the third party involved in the transaction ensure its stake?

b) Explain the difference between entering into a long forward contract with the forward price \$50.00 and buying a call option with a strike price of \$50.00.

c) You enter a short position in a corn futures contract with the futures price 70 cents per pound. The contract is for the delivery of 40,000 pounds. How much do you gain or lose if the corn price at the end of the contract is 68 cents per pound?

3+3+4

5.

a) What are Elliot waves? What do these indicate in terms of stock market predictions?

b) Would you prefer to be among one of the Odd- Lotters? Explain your answer with reasons.

c) Derive the advance –decline line from the following data and interpret the market movement in terms of the breadth of the market.

Day	Advances	Declines
Monday	562	783
Tuesday	651	732
Wednesday	450	842
Thursday	653	499
Friday	702	354

d) What does Semi- Strong form of market informational efficiency hypothesize? How the Residual Analysis Approach is made use of in understanding this form of market efficiency?

2+2+3+3