

## Final Exam

FIN 319  
Winter 2001

University of Michigan  
Business School

Maximum score for each question is in brackets. Please, make your answers as short as you can: you save time on writing, and I – on grading. Also, when you have to be short, you have to think very clearly. It helps when the questions are complex.

Maximum total score is 100, plus 10 extra for a bonus question. The maximum score for each question is in brackets.

**Question 1.** Hedge funds [15 pt, 5 points each] Choose ONLY 3!! out of 5. [No extra credit for doing more]. Define the concepts:

1.1 [5] Hedge fund

1.2 [5] Short position

1.3. [5] Random walk process and random walk process with a drift

1.4 [5] Liquidity

1.5 [5] Highly leveraged

**Questions 2 – 6 are True/ False / uncertain questions. Each question is 5 points. Answer at least 2 out of 4 sub-questions in each question, total is 85 maximum points, i.e. answer 17 sub-questions only.**

Explain your reasons in 1-2-3 sentences.

**Question 2. Hedge funds, group 1.**

2.1 [5] I prefer a risk averse hedge fund manager because he/she will be more prudent with the funds.

2.2 [5] I prefer a risk neutral hedge fund manager because he/she is less constrained, which will raise my expected return, at any given risk level.

2.3 [5] I prefer smaller hedge funds because their operations are more mobile. It helps in the times of turmoil.

**Question 3. Hedge funds, group 2**

3.1 [5] Secrecy was essential for LTCM, especially during the time of 1998 Fall (after the Russian default).

3.2 [5] The more technical are the tools of analysis that specific fund employed, the higher should be the level of secrecy about the fund's operations.

3.3 [5] The more discretion is used by the fund's management the safer is to reveal the information about fund's activities to the markets.

3.4 [5] Moreover, if 5.6 is the case, it could be profitable to make the markets to know about the fund's perspective activities in advance.

#### **Question 4. Institutions**

4.1 [5] Rules of the game are like water under the sun: they come and go, as technology and political powers come and go...

4.2 [5] Rules of the game are like an ink pen in the airplane: it leaks in an unexpected direction, and leaves long lasting spots.

4.3 [5] Sometimes these spots do not matter (see ink pen analogy in question 4.2)

4.4 [5] but sometimes they (see ink pen analogy in question 4.2) are very annoying: they could destroy one's expensive suit with no hope of recovery

#### **Question 5. Enforcement**

5.1 [5] The more liquid the markets are, the higher are enforcement costs

5.2 [5] The higher is market volume, the easier is enforcement, because with more volume, we have more precedents.

5.3 [5] When the enforcement institutions are missing (or weak) investment is lower than when enforcement capabilities are strong

5.4 [5] The improvement in enforcement capabilities results in improved liquidity.

### **Question 6. Regulation**

6.1 [5] Regulations converge overtime. In future, one expects to see that the regulations are identical everywhere

6.2 [5] In different locations regulations will always differ: because there are many other things that differ as well, and will always differ across locations.

6.3 [5] Sometimes, lax regulatory regimes and strong regulatory regimes have the same effects on investment decisions.

6.4 [5] It is better to under-regulate than to over-regulate, because the regulation is costly.

**Bonus [10].** Multiple choice.

Rules of the game are formulated to:

1. be followed
2. be violated
3. be studied in Business Schools
4. all of above
5. non of above