

IB/FIN 614 Int Fin Takehome Midterm 11/15/00 (due - 11/22/00)

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

1. [Total is 19] Please, consider the graphs S&P500, Nasdaq, etc. and the graph at the URL:

http://128.255.244.60/graphs/pres00_WTA.gif

You can get more information at the URL:

http://www.biz.uiowa.edu/iem/markets/pres00_WTA.html]

Describe stock market reaction that you expect if Gore (Bush) wins the elections. Please, use some composite stock market index(es) or /and some individual stocks of your choice to support your intuition. Compare your forecasts with the ones you find in press. Explain the reasons why do you agree or disagree.

2. [Total is 35] True or False. Please, explain your choice in 1 - 5 sentences. Each sub-question is 5 points. Please, answer only 7 sub-questions out of 10.

2.1 The modern markets are increasingly volatile because they are more sophisticated.

2.2 More mature markets, i.e. the markets with higher trading volumes, are more stable, i.e. less volatile.

2.3 More mature markets, i.e. the markets with higher trading volumes, are more profitable.

2.4 When investors are risk neutral, rate of return on capital does not depend on the default rate, (i.e. the proportion of the bad loans).

2.5 Risk averse investors require risk premium, and, thus, earn a higher return than the risk neutral ones.

2.6 Risk averse investors do not hold short positions.

2. 7 Risk neutral investors have a better ability to hedge, which makes their returns higher than the risk averse investor returns.

2. 8 Transaction costs are lower for a high volume investors. Therefore, there rate of return is higher.

2. 9 Offshore customers are high volume customers. Their lower transaction costs permit them cheaper financing of their needs through the use of the offshore markets than they have onshore.

2. 10 Risk neutral investors cannot improve their returns through diversification.

3. [Total is 21] Offshore and onshore markets. Each sub-question is 7 points. Answer three questions out of five.

3.1. State reasons for emergence of the offshore markets

3.2. Define offshore and onshore markets

3.3. Why the same banking institution could offer contracts of both types, offshore and onshore?

3.4 Why the some companies are listed on several exchanges? Please, list the associated costs and benefits.

3.5. Define the concept of Pareto improvement. Give an example of Pareto improvement.

[Here is my example: Introduction of Federal Deposit Insurance.]

4. [25] Derivative security markets. See Levich, chapter 11.

4.1 [10] Levich, pp. 383-384.

Explain as good as you can the empirical fact of *increased* (rather than decreased) volatility with the higher transaction taxes.

[Hint: What does this fact imply about noise traders?]

4.2 [5] See Levich, pp. 379-380. Though what channel the speculators could reduce the costs of hedging? [Hint: relate this question to the concept of liquidity]

4.3 [10] renumerate the reasons why derivative securities are present in the markets.

[In following format: task: to improve liquidity. means (or instrument): margin requirement.]

(**Bonus** 10 points). [Limit your answer to 0.5 of a page!!! You can make your points as an outline.]

Please, read the article “Conspiracy Theory Gains New Currency, Thanks to Prof. Auriti — His Odd Monetary Experiment Ignites a Shopping Frenzy In a Small Italian Town,” Wall Street Journal; New York, N.Y.; Oct 6, 2000. Make an educated comment about the story (incentives behind the actions of the government / banking officials, academicians, etc). Why / how the story ‘made it’ to the Wall Street Journal first page?

(**Bonus** alternative 10 points) [Limit your answer to 0.5 of a page!!! You can make your points as an outline.]

Who is to be next US president? Please, kindly state for whom you have voted (or who would have been your choice if you voted). *** Notice that you can lie here whatever you prefer me to get from you! *** Keep in mind that I do not provide you with any clues about HOW I will be grading this question. [Historically, I do my best to reward the proper ability to *reason*.]

Do you think that Florida elections were ‘clean’? Do you expect that the hand recount of the ballots in Palm Beach county could change the winner? Explain why or why not.

Bonus alternative. Levich, Chapter 11. [True / false]

Prof. Levich appears to relate futures [both, interest rate and currency] with bankruptcy [chapter 11]. Explain your intuition.