FINA 0025 –Financial Management
Tutorial 8 - Questions

These questions do not need to be submitted and will be discussed at the tutorial. Note that detailed answers to these questions will only be provided in tutorials. This policy is in place to ensure that you attend your tutorial regularly and receive timely feedback from your tutor. If you are unsure of your answers you should check with your tutor, a pit stop tutor or the lecturer.

A. Short Answer Questions
Answer true or False to the following questions providing justification.

A1. The dividend discount model will undervalued stocks because it is too conservative.

A2. Increasing dividend payments to shareholders generally makes bondholders in the firm better off.

A3. Beta is not the same as the correlation between a security (portfolio) and the market portfolio.

A4. The existence of market anomalies is consistent with the CAPM.

A5. One of the major assumptions of market efficiency is that new information comes to the market in a random manner and that the timing of announcements is independent of other announcements.

A6. The expected return on the share market is 8% with a standard deviation of 15%. The risk-free rate is 3%. The correlation coefficient between Melbourne Corporation's returns on common shares and the market is 0.5. Melbourne will pay a dividend of $1.50 per share next year, its growth rate is 4%, and the standard deviation of its returns is 60%. The shares are trading at $18.87. Because the shares are worth more than its current market price, they should be bought.

A7. Both the Capital Market Line and the Security market Line may contain efficient and inefficient portfolios.

A8. As investors become more risk averse the market price of risk increases and stock values fall.

A9. If interest rates for bonds of all maturities increase by one percent, the **percentage change in price** of shorter maturity bonds and longer maturity bonds will be the same.

B. Problems
B1. You have a $1000 par value, 5% coupon (nominal rate) US Treasury bond with 7 years remaining until maturity. Coupons are paid semiannually and the next coupon payment is exactly six months away. The market interest rate for these bonds is 6% (nominal rate with semiannual compounding). What is the current price of this bond?

B2. Price a zero coupon bond with a par value of $100,000 maturing in 7 years. Assume that the nominal interest rate is 6% and interest is compounded semiannually.

B3. Define systematic and unsystematic risk and explain why an investor should not expect to receive additional return for assuming unsystematic risk.

B4. What is the difference between a projects internal rate of return (IRR) and the Opportunity Cost of Capital?

B5. In an efficient market, what would happen if a projects' IRR was greater than the Opportunity Cost of Capital?