CONFIDENTIAL

UNIVERSITI KUALA LUMPUR
BUSINESS SCHOOL

FINAL EXAMINATION
MARCH 2024 SEMESTER

COURSE CODE	:	**EGB30103**
COURSE NAME	:	**FINANCIAL ECONOMICS 2**
PROGRAMME NAME	:	**BACHELOR OF SCIENCE (HONS) IN ANALYTICAL ECONOMICS**
DATE	:	**4 JULY 2024**
TIME	:	**2.00 PM – 5.00 PM**
DURATION	:	**3 HOURS**

INSTRUCTIONS TO CANDIDATES

1. **Please CAREFULLY read the instructions given in the question paper.**
2. **This question paper has information printed on both sides of the paper.**
3. This question paper consists of **TWO (2)** sections; **Section A** and **Section B**.
4. Answer **ALL** questions from **Section A** and **Section B**.
5. Please write your answers on the answer booklet provided.
6. All questions must be answered in **English** (any other language is not allowed).
7. **This question paper must not be removed from the examination hall.**

THERE ARE FOUR (4) PAGES OF QUESTIONS, EXCLUDING THIS PAGE.

SECTION A (Total: 30 marks)

INSTRUCTION: Answer ALL questions.
Please use the answer booklet provided.

Question 1

a) Explain what is meant by informational asymmetries.

(5 marks)

b) Describe the adverse consequences to a financial system that are created by informational asymmetries.

(5 marks)

Question 2

a) Explain under what circumstances can financial intermediaries create value.

(5 marks)

b) Explain how the financial intermediary can mitigate the effects of adverse selection.

(5 marks)

Question 3

a) Describe how risk can be categorized.

(5 marks)

b) Explain why modelling risk an important task in risk management.

(5 marks)

SECTION B (Total: 70 marks)

INSTRUCTION: Answer ALL questions.
Please use the answer booklet provided.

Question 4

a) Many risk measures have been proposed in the financial economics literature, describe what does each measure attempt to do.

(5 marks)

b) Assuming that the appropriate asset-pricing model is the capital asset pricing model, explain the meaning of a two-fund separation.

(5 marks)

Question 5

a) Arbitrage opportunities include only situations where an investor can realize something of an economic value today at no cost and incur no future obligations. Explain whether you agree or disagree.

(5 marks)

b) Assume a finite state economy with three assets whose payoff matrix is given by

$$X = \begin{matrix} \$30 & \$20 & \$10 \\ \$20 & \$15 & \$0 \end{matrix}$$

i- Determine the payoffs of the second asset.

(2 marks)

ii- Explain whether the second asset is redundant.

(3 marks)

Question 6

a) From the perspective of a counterparty risk, differentiate between a futures and a forward contract.

(5 marks)

b) Comment on the following statement: Unlike a forward contract, a futures contract requires marking to market.

(5 marks)

Question 7

a) Explain how operating decisions of management may be affected by the probability of the firm's technical insolvency.

(5 marks)

b) Explain why the magnitude of the influence by the technical insolvency may depend on whether management is more self-oriented or more shareholder-oriented.

(5 marks)

Question 8

a) List two (2) factors that make the timing and frequency of the issuance of new debt securities important for management.

(5 marks)

b) Describe restrictive covenants.

(5 marks)

Question 9

a) Differentiate between sensitivity analysis and simulation analysis.

(5 marks)

b) Explain why is the internal rate of return method a better method to employ in capital budgeting analysis than the net present value method when evaluating/assessing a project's attractiveness under different scenarios.

(10 marks)

c) Explain the relationship between the volatility of an investment opportunity's cash flows with its static net present value and value of the option.

(5 marks)

END OF EXAMINATION PAPER