

KIBABII UNIVERSITY



(KNOWLEDGE FOR DEVELOPMENT)

UNIVERSITY EXAMINATIONS

SPECIAL/SUPPLEMENTARY

2020/2021 ACADEMIC YEAR

SECOND YEAR FIRST SEMESTER

**FOR THE DEGREE OF MASTER OF BUSINESS
ADMINISTRATION**

COURSE CODE: MBA 831

COURSE TITLE: FINANCIAL ECONOMICS

DATE: 24TH SEPTEMBER, 2021 TIME: 2.00PM – 5.00PM

INSTRUCTIONS TO CANDIDATES

Answer Question ONE (compulsory) and ANY OTHER THREE questions

QUESTION ONE.

- (a) Explain what you understand by the concept 'financial system'. (8 marks)
- (b) Which features should a comparatively efficient money market possess for it to be responsive to changes in demand for and supply of funds in any of its segments? (6 marks)
- (c) What are the building blocks of a theoretical model of financial markets? (4marks)
- (d) Describe the contributions of the following personalities to development of financial economics.
- i). Harry Markowitz (4marks)
- ii). Merton Miller. (4marks)
- (e) Explain the meaning of the following terms as used in financial economics.
- (i) Price functional (2marks)
- (ii) Hedging (2marks)
- (iii) Pareto efficiency (2marks)
- (f) What are the basic attributes of an ideal financial system? (8 marks)

QUESTION TWO

- (a) Explain the meaning of the Capital Market and analyze the functions of an active Capital Market. (10 marks)
- (b) Outline the factors one would consider before investing in a mutual fund.(10 marks)

QUESTION THREE

- (a) Explain the meaning of the term 'Capital Market' and expatiate functions of an active Capital Markets. (10 marks)
- (c) Explain the application of capital asset pricing model in the pricing of assets.(10marks)

QUESTION FOUR.

- (a) Using algebra, explain arbitrage strategy. (12marks)
- (b) Explain the application o the theory of Rational Expectation to security and commodity markets. (8marks)

QUESTION FIVE

- (a). Explain the elements of the discrete multiperiod model of financial markets.(8marks)
- (b). Discuss the elements, Conditions and forms of market efficiency based on the efficient market Hypothesis. (12marks)

QUESTION SIX

There are $K=3$ states and $N=3$ securities with the following payouts.

$$D_1(w_1) = 12 \quad d_2(w_1) = 22 \quad d_3(w_1) = 6$$

$$D_1(w_2) = 10 \quad d_2(w_2) = 22 \quad d_3(w_2) = 6$$

$$D_1(w_3) = 24 \quad d_2(w_3) = 18 \quad d_3(w_3) = 6$$

The prices for securities are $p_1 = 17.50$

$$P_2 = 20, \quad p_3 = 6$$

- (a). Find the set of all attained consumption processes. (5marks)

(b). i). Is the consumption process

$$C(0) = 5, \quad c(T_1w_1) = 3, \quad c(t_1w_1) = 2.5 \quad \text{and} \quad c(T_1w_3) = 5 \quad \text{attainable?} \quad (5\text{marks})$$

ii). Find the initial endowment and trading strategy that will attain the consumption process in b (i) above. (5marks)

- (c). Does the given price system permit arbitrage strategy. (5marks)