KIBABII UNIVERSITY

(KNOWLEDGE FOR DEVELOPMENT)

UNIVERSITY EXAMINATIONS (MAIN EXAM)

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: 05/08/2021 TIME: 9.00 a.m – 11.00 a.m

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)

QUESTHION SIX

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

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

$D1(w_2) = 10\ d_2(w_2) = 22\ d_3(w_2) = 6$

$D1(w_3) = 24\ d_2(w_1) = 18\ d_3(w_3) = 6$

The prices for securities are p1 = 17.50

$P_2 = 20, p_3 = 6$

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

(b). i). Is the consumption process

C (0) = 5, c (T_1w_1) = 3, c (t_1w_1) = 2.5 and c(T_1w_3) = 5 attainable? (5marks)

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)