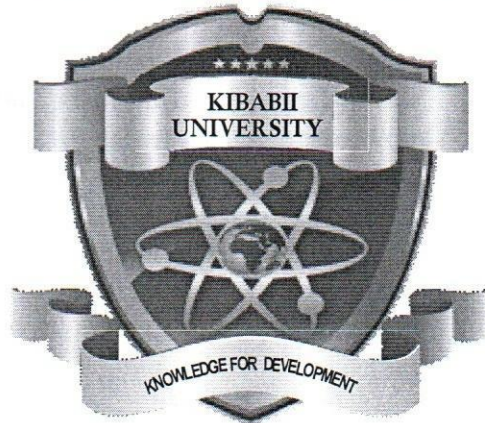


KIBABII UNIVERSITY



(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. (2marks)
- (i) Price functional (2marks)
- (ii) Hedging (2marks)
- (iii) Pareto efficiency (8 marks)
- (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.

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

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

$$D_1(w_3) = 24 \quad d_2(w_1) = 18 \quad d_3(w_3) = 6$$

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

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

(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)