Student Nr: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Name: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Surname: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Exam rules:

* Only the answers in the spaces underlying the questions will be corrected. Answers on scratch papers are not allowed
* Students are not allowed to use notes, books and slides
* Smartphones, tablets, smartwatches and PCs must be switched off during the exam.
* The exam is composed of 10 open-end questions and 3 exercises. Overall this midterm exam counts 60% of the final grade, the remaining 40% resulting from the second midterm exam.

1. Primary market trades provide liquidity to financial instruments typically involving institutional investors, but secondary market trades, which involve retail investors, are more important in that they allow firms to get new money. True/False/Uncertain. Explain

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1. Regulators can ensure soundness only by requiring financial institutions to maintain enough capital to hedge against the risks borne. True/False/Uncertain. Explain

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1. The higher the maturity and the coupon rate on the bond, the higher its duration. True/False/Uncertain. Explain

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1. The minimum capital requirement does not change when the financial institution uses the proceeds from bonds to invest in equity instrument. True/False/Uncertain. Explain

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1. Usually, financial markets react negatively when central banks cut the interest rate since investors expect to receive smaller interests on their investments. True/False/Uncertain. Explain.

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1. Money market instruments are typically issued by corporations of emerging markets. True/False/Uncertain. Explain

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1. When the central bank sells treasury bonds on the market (money market operations) it creates monetary base. The likely effect is a decrease in short term interest rates. True/False/Uncertain. Explain

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1. The Basel accord on bank capital is meant to cover against banks expected losses. True/False/Uncertain. Explain

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1. Central Banks can control both the Money Supply and the shortterm interest rates level.

True/False/Uncertain. Explain \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1. An increase in the perceived riskiness of corporate bonds (increase of perceived default risk), in general, results in an increase in their risk premium versus risk free bonds. This is due to the fact that the interest on corporate bonds increase more than the increase in risk free bonds (all things equal also interest rates on risk free bond increase but less than interest rates on corporate bonds). True/False/Uncertain. Explain
2. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_
3. Compute the present value of the following bond:
   1. 2 years to maturity;
   2. Semi-annual coupon
   3. Coupon 3 paid every 6 months
   4. Face value – 100
   5. Annual Interest rate 2%
4. Compute the price and the duration of the following bonds supposing that the interest rates are 5% and that they remain constant over time.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| *Year* | *0* | *1* | *2* | *3* | *4* |
| Bond #1 | P? | 5 | 5 | 5 | 105 |
| Bond #2 | P? | - | - | - | 100 |
| Bond #3 | P? | 40 | 25 | 20 | 15 |

Briefly comment the differences.Compute the expected change in prices for each bond due to a 0.5% increase in interest rates.

1. Company FS has just announced its dividend policy. It assumes the dividend growth in line with OECD GDP growth, which is estimated around 2.5% for the foreseeable future. FS expected return on equity is equal to 9% and the next dividend is expected to be 10 €. Calculate the expected stock price according to the Gordon’s model. The stock is trading at 150. Would you buy or sell the stock?

**BONUS**. Which implied growth is the 150 stock price assuming?