

NATIONAL UNIVERSITY OF SCIENCE AND TECHNOLOGY
FACULTY OF COMMERCE
DEPARTMENT OF FINANCE
BACHELOR OF COMMERCE HONOURS DEGREE IN FINANCE
PART IV - FINAL EXAMINATION – JUNE 2010
INTERNATIONAL FINANCE II [CFI 4202]
TIME ALLOWED: 3 HOURS

Instructions to Candidates

Answer **Section A** and **three (3)** questions from **Section B**

SECTION A [40 marks]

Question 1

- a) Stock A has an expected return of 12% and a variance of 0.04. Stock B has an expected return of 9% and a variance of 0.02. Finally, stock C has an expected return of 15% and a variance of 0.05. The correlations between these three stocks are $\rho_{A,B} = .7$, $\rho_{A,C} = .8$, and $\rho_{B,C} = .75$. What is the expected return and variance of the return for a portfolio consisting of 20% stock A, 35% stock B, and 45% stock C? [8 marks]
- b) Suppose that you have a 100% Canadian asset portfolio. Suppose that it has a higher expected rate of return and a lower standard deviation(risk) compared to the Hong Kong stocks (index or the stock market in general). Would you be better off in any way by adding some of Hong Kong stocks to your existing 100% Canadian-asset portfolio? Explain why or why not. [5 marks]
- c) In the calculation of the cost of equity capital for the multinational enterprises (MNEs) that are owned by shareholders in many countries, the CAPM-assumptions must be adapted to the international environment. Explain the most important modifications of the assumptions that should be introduced in such a model. [4 marks]

Question 2

Place the following factors into unsystematic and systematic categories of risk

- a) A firm's technical wizard is killed in an auto accident
- b) Parliament votes for a massive tax cut
- c) Oil is discovered on a firm's property
- d) The Federal Reserve follows a restrictive monetary policy
- e) There is a precipitous rise in long-term interest rates [5 marks]

Question 3

Suppose a U.S. parent owes \$5 million to its English affiliate. The timing of this payment can be changed by up to 90 days in either direction. Assume the following effective annualized after-tax dollar borrowing and lending rates in England and the United States:

	<u>Lending(%)</u>	<u>Borrowing(%)</u>
United States	4.0	3.2
England	3.6	3.0

(a.) If the U.S. parent is borrowing funds while the English affiliate has excess funds, should the parent speed up or slow down its payment to England? [4 marks]

(b.) What is the net effect of the optimal payment activities in terms of changing the units' borrowing costs and/or interest income? [4 marks]

(c.) A well-known U.S. firm has a re-invoicing center (RC) located in Geneva. The re-invoicing center handles an annual sales volume of \$1.2 billion--\$700 billion in inter-affiliate sales and the rest in third-party sales. The RC buys goods manufactured by the parent company or other subsidiaries and re-invoices the product to other affiliates or third parties. Many of these trades are with "low-volume, highly complex countries." When buying the goods, the RC takes title to them, but it does not take actual possession of the goods. The RC pays the selling company in its own currency and receives payment from the purchasing company in its own currency. What **five** benefits can such a center provide to its parent company? [10 marks]

SECTION B [60 marks]

Question 4

The relationship between an MNC and a host government can be mutually beneficial. However, this relationship can also lead to conflicts concerning what the goals of the MNC should be. What are these benefits and conflicts?

[20 marks]

Question 5

How does the internal financial transfer systems add value to multinational firms?

[20 marks]

Question 6

Under what circumstances is leading and lagging likely to be of most value since companies can hedge their exchange risk in other ways. ?

[20 marks]

Question 7

Explain by means of a diagram how international diversification of a stock portfolio can reduce the risk of the portfolio. Why is the internationally diversified opportunity set different from the domestic portfolio opportunity set and what is according to portfolio theory an optimal international portfolio?

[20 marks]

Question 8

With regard to international debt crisis, would banks be better off acting as a group or individually in negotiating the rescheduling of loans? Discuss

[20 marks]