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Mid-Term Assessment
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Financial markets and Institutions-FIN 439

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Answer to the question no-2

Explain the loanable funds theory there are given below :- The loanable funds theory commonly used to interest rate movements suggests that the market interest rate is determined by the factors that the control the supply of and demand for loanable funds. The theory is especially useful for explaining movements in the general level of interest rates for a particular country.

There are some sectors of loanable funds theory :-

(i) Household demand for loanable funds :-

Household commonly demand loanable funds to finance housing expenditures. In addition they finance the purchases of automobiles and household items, which results in installment debt. This simply means that at any point in time households would demand a greater quantity of loanable funds at lower rates of interest.

(ii) Business demand for loanable funds :-

Business demand loanable funds to invest in long-term and short-term assets. The quantity of funds demanded by business depends on the number of business projects to be implemented.

(iii) Shifts in the demand for loanable funds:

The business demand for loanable funds schedule can shift in reaction to any events that affect business borrowing preferences. if economic conditions become more favorable the expected cash flows on various proposed projects will increase.

(iv) Government demand for loanable funds:— whenever a government's planned expenditures cannot be completely covered by it's incoming revenues from taxes and other sources, it demands loanable funds. Municipal governments issue municipal bonds to obtain funds, while the federal government and it's agencies issue treasury securities and federal agency securities. These to securities represent government debt.

(v) Foreign demand for loanable funds:— The demand for loanable funds in a given market also includes foreign demand by foreign governments or corporations. The foreign demand schedule can shift in response to economic conditions.

(vi) Supply of loanable funds:— The term supply of loanable funds, is commonly used to refer to funds provided to financial markets by savers.

The supply of loanable funds exists at even a very low interest rate it's called the loanable funds theory.

Answer to the question no-3

Estimate the appropriate yield for any particular debt security there are given below:- The appropriate yield for any particular debt security can be estimated by first determining the risk-free yield that is currently offered by a treasury security with a similar maturity. Then adjustments are made that account for credit risk, liquidity, tax status and other provisions. The discussion up to this point suggests that the appropriate yield to be offered on a debt security is based on the risk-free for the corresponding to maturity, with adjustments characteristics. Here are the four main types of yields:-

(i) The bank discount yield.
(ii) Holding period yield.
(iii) effective annual yield.
(iv) money market yield.

I know about tax status and liquidity there are given below:-

Tax status:- Investors are more concerned with after-tax income than before-tax income earned on securities. If all other characteristics are similar, taxable to securities will have to offer a higher before-tax yield to investors than

tax-exempt securities to be Preferred. the extra compensation required on such taxable securities depends on the tax rates of individual and institutional to investors. Investors in high tax brackets benefit most from tax exempt securities. when assessing the expected yields of various securities with similar risk and the maturity, it is common to convert them into an after-tax form, as follows:-

$$Y_{at} = Y_{bt}(1-T)$$

Y_{at} = after-tax yield

Y_{bt} = before-tax yield

T = Investor's marginal tax rate.

Liquidity:- Investors prefer securities that are liquid, meaning that they could be easily converted to cash without a loss in value. thus, if all other characteristic are equal, securities with less liquidity will have to offer a higher yield to be Preferred. securities with short-term maturity or an active secondary market have greater liquidity. FOR investors who will not need their funds until the securities mature, less liquidity is tolerable. other investors, however, are willing to accept a lower return in exchange for a high degree of liquidity.

Answer to the question no-4

The securities traded in financial market there are given below:- Each type of security tends to have specific return and risk characteristics, as described in detail in the covering financial market. The term risk is used here to represent the uncertainty surrounding the expected return. The more uncertain the expected return, the greater the risk is, when surplus units have funds available for one for example, they can purchase one-year treasury securities and know exactly what return they will receive on their investment. In contrast, the return from investing in debt securities issued by firms is not guaranteed because the firms could go bankrupt and never repay the surplus units. Equity securities are also risky because their values depend on the future performance of the firms that issued them. Surplus units will consider investing in a risky security only if it has the potential to offer a higher return than what they can earn on a risk-free investment such as a treasury security. In other words, the issuer of a security has to price the security such that

the expected return is sufficient to compensate for the risk. Thus, there is a positive relationship between the risk of a security and the expected return to be earned from investing in that security. securities can capital market securities or derivative securities.

There are 2 capital market securities are given below:-

(i) Bonds.

(ii) Stocks.

(i) Bonds:- Bonds are long-term debt securities issued by corporations and government agencies to support their operations. Bonds provide a return to investors in the form of the interest income every six months. Since the prices of debt securities can change over time, investor may be able to enhance their return by selling the securities for a higher price than they paid for them.

(ii) Stocks:- Stocks are certificates representing ownership in the corporations that issued them. They are classified as capital market securities because they have no maturity and therefore serve as a long long term source of funds. Other corporation retain and reinvest all of their earnings which allows them more potential for

Answer to the question no-5

The most relevant factors that affect interest rate movements there are given below:-

(i) Economy.
(ii) Inflation.
(iii) RBI moves.
(iv) Stock market conditions.
(v) International borrowings.
(vi) Fiscal deficit and government borrowings.

(i) Economy:- The general economic conditions are among the prime factors that influence the movement of interest rate. In a growing economy people have secure sources of earnings and hence high confidence levels to borrow and buy.

(ii) Inflation:- The rate of inflation is the another important factor that governs to interest rates on loans. The lenders prefer landing at interest rates that are higher than the rate of inflation. on the other hand, a drop in the rate of inflation indicates a softer interest rate regime.

(iii) RBI moves:- The RBI governs the monetary Policy. it controls the monetary to the activities such as money supply, liquidity

Policy rates.

(iv) Stock market conditions :- Corporates meet their needs of funds through equity to expansions in the stock markets or the borrowing from financial institutions. On the other hand, a sluggish stock market condition induces corporates to go in for the borrowing route, and thus increases the demand for funds.

(v) International borrowings :- With the increasing globalisation over last few years, the economic conditions of international markets have also started playing an important role in deciding the interest rate direction. The global economic to conditions influence the lending pattern of foreign investors to domestic companies.

(vi) Fiscal deficit and government borrowings :- The government policies and their impact on the fiscal deficit is another factors that influences the interest rates to indirectly. The government borrows to money from the market to fund its fiscal deficit. This puts an indirect to upward pressure on the borrowing rates in the markets.

Answer to the question no-6

Short notes:-

Liquidity

Investors Prefer securities that are liquid meaning that they could be easily converted to cash without a loss in value. Thus, if all other characteristics are equal, securities with less liquidity will have to offer higher yield to be preferred. Securities with a short-term maturity or an active secondary market have greater liquidity. other investors, however, are willing to accept a lower return in exchange for a high degree of liquidity.

Tax Status

Investors are more with after-tax income than before-tax income earned on securities if all other characteristics are similar, taxable securities will have to offer a higher before-tax yield to investors than tax exempt securities to be preferred. The extra compensation required on such taxable securities depends on the tax rates of individual and institutional investors. Investors in high tax brackets benefit most from tax-exempt securities.

Yield

Yield refers to the earnings generated and realized on an investment over a particular period of time. It's expressed as a percentage based on the invested amount, current market value, or face value of the security. Yield includes the interest earned or dividends received from holding a particular security.

Corporate Governance

Corporate governance is the system by which companies are directed and controlled. Boards of directed and responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. all over corporate governance is the structure of rules, practices, and processes used to direct and manage a company.