

School of Economics and Finance

FINA412: APPLICATIONS AND EXTENSIONS OF THE CAPM

Trimester 2 2012

COURSE OUTLINE

Names and Contact Details

The Course Coordinator and lecturer for the course is Martin Lally, RH 301, ext 5998, martin.lally@vuw.ac.nz. Students are free to contact him at any time.

Any administrative matters should be brought to the attention of Bonnie Riley, RH321, ext 5380, bonnie.riley@vuw.ac.nz. Office hours are 9am-12pm and 1-4pm.

Trimester Dates

Teaching Period: Monday 16 July – Friday 19 October
Study Period: Monday 22 October – Thursday 25 October (Monday 22 October is a public holiday, Labour Day)
Examination Period: Friday 26 October – Saturday 17 November (inclusive)

Withdrawal from Course

1. Your fees will be refunded if you withdraw from this course on or before Friday 27 July 2012.
2. The standard last date for withdrawal from this course is Friday 28 September. After this date, students forced to withdraw by circumstances beyond their control must apply for permission on an '*Application for Associate Dean's Permission to Withdraw Late*' including supporting documentation.

The application form is available from either of the Faculty's Student Customer Service Desks.

Class Times and Room Numbers

Classes will run on Fridays from 2.40pm till 4.30pm in RWW126.

Course Content

See page 5.

Course Learning Objectives

The course learning objectives are as follows:

- To demonstrate an understanding of selected extensions to the Capital Asset Pricing Model, and the estimation of parameters in those models. The exam and weekly assignments relate to this.

- To demonstrate an ability to critically assess a piece of financial analysis involving some of the preceding issues. The essay relates to this.

Course Delivery

The delivery of the course will involve weekly classes, involving review of the previous week's assignment and the presentation of new material.

Expected Workload

A minimum of 14 hours per week, comprising 3 hrs for the class, 3 hrs in preparing the weekly assignment, 4 hrs in undertaking the background reading, and 4 hrs in researching and writing the essay. In addition, students will require time in preparation for the exam.

Readings

See page 5.

Materials and Equipment

Students are permitted to use electronic calculators in the exam, providing that they are not programmable and do not have a full set of alphabetic keys.

Assessment Requirements

The final mark for the course will be based upon the following approximate weights

Weekly assignments	25%
Essay	25%
Final Exam	50%

The essay comprises a critical review of *Internal Consistency of the Risk Free Rate and the Market Risk Premium in the CAPM* (<http://www.aer.gov.au/sites/www.aer.gov.au/files/H-2%20CEG%20Internal%20consistency%20in%20Risk%20Free%20Rate%20and%20MRP%20in%20the%20CAPM.pdf>). It must be typed, 1.5 spaced A4, font 12, with a maximum of 18 pages at 25 lines per page excluding the bibliography (approx. 6000 words). Pages must be **numbered**. Students should consult a book on essay style and may also wish to examine the following example of a critical review: *Investing in New Zealand: A Review* (www.nzsuperfund.co.nz). An Executive Summary is not required. The Introduction and Conclusion should be brief. The due date is **Friday 19 October** (4.30pm).

Quality Assurance Note

Your assessed work may also be used for quality assurance purposes, such as to assess the level of achievement of learning objectives as required for accreditation and audit purposes. The findings may be used to inform changes aimed at improving the quality of FCom programmes. All material used for such processes will be treated as confidential, and the outcome will not affect your grade for the course.

Examinations

Students who enrol in courses with examinations are obliged to attend an examination at the University at any time during the formal examination period.

The final examination for this course will be scheduled at some time during the period from Friday 26 October – Saturday 17 November (inclusive).

Penalties

Late essays will suffer a penalty of 5% per business day (i.e. marked out of 95, 90, etc.) unless an extension has been granted in advance for significant medical or personal problems. Essay material in excess of the limit prescribed above will **not** be evaluated.

Mandatory Course Requirements

There are no mandatory requirements for passing the course.

Class Representative

An Honours programme representative will be elected in the first class, and that person's name and contact details made available to VUWSA, the Course Coordinator and the class. The class representative provides a communication channel to liaise with the Course Coordinator on behalf of students.

Communication of Additional Information

Additional information will be conveyed to students during classes.

Use of Turnitin

Student work provided for assessment in this course may be checked for academic integrity by the electronic search engine <http://www.turnitin.com>. Turnitin is an on-line plagiarism prevention tool which compares submitted work with a very large database of existing material. At the discretion of the Head of School, handwritten work may be copy-typed by the School and subject to checking by Turnitin. Turnitin will retain a copy of submitted materials on behalf of the University for detection of future plagiarism, but access to the full text of submissions will not be made available to any other party.

Academic Integrity and Plagiarism

<http://www.victoria.ac.nz/home/study/plagiarism.aspx>

General University Policies and Statutes

Find key dates, explanations of grades and other useful information at

www.victoria.ac.nz/home/study

Find out about academic progress and restricted enrolment at

<http://www.victoria.ac.nz/home/study/academic-progress.aspx>

The University's statutes and policies are available at www.victoria.ac.nz/home/about/policy, except qualification statutes, which are available via the Calendar webpage at

<http://www.victoria.ac.nz/home/study/calendar.aspx> (See Section C).

Further information about the University's academic processes can be found on the website of the Assistant Vice-Chancellor (Academic) at

www.victoria.ac.nz/home/about_victoria/avcacademic/default.aspx

AVC (Academic) Website: information including: Conduct, Academic Grievances, Students with Impairments, Student Support

http://www.victoria.ac.nz/home/about_victoria/avcacademic/Publications.aspx

Faculty of Commerce Office

<http://www.victoria.ac.nz/fcom/studenthelp/>

Te Putahi Atawhai
Maori and Pacific Mentoring Programme
<http://www.victoria.ac.nz/tpa/>

Course Content

The following topics will be examined:

1. Extensions of the CAPM to deal with personal taxes: July 20, 27, August 3
2. Extensions of the CAPM to deal with international investment opportunities: Aug 10, 17
3. Price setting under the CAPM: August 24
4. Estimation of beta: Sept 14, 21, 28
5. Estimation of the market risk premium: Oct 5, 12, 19

Readings

Prescribed reading for the seminar topics is as follows:

1. Extensions of the CAPM to deal with personal taxes

Lally, M., 1992. "The CAPM Under Dividend Imputation", *Pacific Accounting Review*, vol.4, 31-44.

_____ 2000. "Valuation of Companies and Projects Under Differential Personal Taxation", *Pacific-Basin Finance Journal*, vol. 8, 115-133.

Officer, R., 1994. "The Cost of Capital of a Company Under an Imputation Tax System", *Accounting and Finance*, vol. 34, 1-18.

2. Extensions of the CAPM to deal with international investment opportunities

Solnik, B., 1974. "An Equilibrium Model of the International Capital Market", *Journal of Economic Theory*, 500-524.

Stulz, R., 1995. "International Portfolio Choice and Asset Pricing: An Integrative Survey", in R. Jarrow et al (ed), *Handbooks in Operations Research and Management Science*, vol. 9, Elsevier Science BV.

3. Price Setting Under the CAPM

Hirshleifer, J., 1970. *Investment, Interest and Capital*, Prentice-Hall Inc., Ch 10.

4. Estimation of Beta

Miles, J. and Ezzell, J., "Reformulating Tax Shield Valuation: A Note". *Journal of Finance*, (1985), pp. 1485-92.

Conine, T., "Corporate Debt and Corporate Taxes: An Extension", *Journal of Finance* (1980), pp 1033-1036.

Cornell, B. and Green, K., "The Investment Performance of Low-Grade Bond Funds", *Journal of Finance* (1991), pp. 29-48.

Ehrhardt, E. and Shrieves, R., "The Impact of Warrants and Convertible Securities on the Systematic Risk of Common Equity", *The Financial Review* 30 (1995), pp 843-856.

Lally, M., "An Examination of Blume and Vasicek Betas", *The Financial Review* 33, (1998), pp 183-198.

_____ "Correcting Betas for Changes in Firm and Market Leverage", *Pacific Accounting Review* 10, (1998), pp. 97-115.

_____ "Betas and Market Leverage", *Accounting Research Journal* 15(1), (2002), pp. 91-97.

5. Estimation of the Market Risk Premium

Siegel, J., "The Equity Premium: Stock and Bond Returns Since 1802", *Financial Analysts Journal* (Jan-Feb 1992), pp 28-38.

Dimson, E., Marsh, P. and Staunton, M. "Global Evidence on the Market Risk Premium", *Journal of Applied Corporate Finance*, vol. 15 (4), Fall 2003, pp. 27-38.

Lally, M., "Time-Varying Market Leverage, the Market Risk Premium and the Cost of Capital", *Journal of Business Finance and Accounting* 29 (2002), pp. 1301-1318.

Merton, R., "On Estimating The Expected Return on the Market", *Journal of Financial Economics* 8 (1980), pp 323-361.

Cornell, B., *The Equity Risk Premium*, John Wiley & Sons Inc (1999), Ch 3.

Bernstein, P. and Arnott, R. "Earnings Growth: The Two Percent Dilution", *Financial Analysts Journal*, Sept-Oct 2003, pp. 47-55.

Cooper, I., "Arithmetic Versus Geometric Mean Estimators: Setting Discount Rates for Capital Budgeting", *European Financial Management* 2, (1996), pp. 157-67.