FIN3005 – fall 2017

Candidate 10017

Grade A

In addition to the mandatory Question 1 about the equity premium puzzle, this candidate chose to answer Question 4 about complications caused by the use of physical assets as collateral for debt, and Question 5 about the systemic implications of securitisation.

The answer to Question 1 is very good. The candidate derives the basic theoretical formula for the equity premium, goes on to derive the more specific formula within the confines of the Lucas tree model with expected power utility, as specified in the question. The follows a clear exposition of the puzzle as an empirical and not a theoretical one. The answer concludes with an explanation of why this model does not provide a satisfactory solution to the equity premium puzzle.

The answer to Question 3 has some details missing, but on the whole gives an excellent account of model by Kiyotaki and Moore. A graph is provided to explain the static effects. The dynamic effects around the steady state are described verbally and outlined algebraically. Above all, the answer reveals a clear understanding of the key mechanisms of the model.

The answer to Question 5 is excellent. The main issues and conclusions of the Gennaioly-Shleifer-Vishny model are derived algebraically and illustrated graphically. And again, the verbal discussion reveals a clear understanding of the relevant issues in this model.

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