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(Do not write anything on question paper except Roll No.)
[This paper consists of FOUR Pages]

Jagan Institute of Management Studies
End-Term Examination, December 2017 – January 2018
Trimester V – PGDM 2016-18

International Financial Management
ET_PG_IFM_0201

Time: 3 Hrs. *M. Marks: 70*

INSTRUCTIONS: Attempt any FIVE questions including Q7 which is compulsory.

Q 1 A Multinational Consumer Electronic goods manufacturing company in Amsterdam, proposes to invest its surplus funds of €10 million for three months. The Vice-President (Finance) has collected the following information from his banker to invest in currencies including that of home currency to earn more interest income. The company do not want to expose the investment to exchange risk for that the company will take cover in the forward market.

Spot	US$/€	1.4701/05
	€/£	1.3455/57
	$/HK$	0.1282/84
3 months forward	US$/€	1.4705/07
	€/£	1.3416/18
	$/HK$	0.1285/87

3 months interest rates (p.a.)

US $:	4.50% – 4.75%
HK$:	3.50% – 3.75%
Euro :	4.60% – 4.85%
£ :	5.50% – 5.75%

You are **required** to determine the currency in which the company should invest to have more returns. **13**

Q 2 Venus International Diamonds Services (P) Ltd., located in Special Economic Zone, Surat, imports rough diamonds from Belgium and exports polished diamonds to various countries.

The company have payables of euro 200,000 and receivables of US$500,000 after three months.

The following exchange rates are available in the market

	Rs/euro	Rs/US$
Spot	57.91/93	39.37/39
1 month forward	16/18	10/12
2 month forward	25/27	16/18

3 month forward	33/35	21/23

The current interest rates (per annum) are as under

Maturity	Rupee (%)	euro (%)	US$ (%)
1 month	6.00 / 7.00	4.20 / 4.70	4.50 / 4.80
2 month	6.50 / 7.50	4.40 / 4.90	4.60 / 4.90
3 month	7.00 / 8.00	4.65 / 5.15	4.70 / 5.00

The company is considering covering the exposures either through the forward market or money market.

You are **required** to advise the company as to which alternative should be better for covering both the payables and receivables. **13**

Q 3 The following are the quotes available at the market

Spot	$ / Euro	1.1496/98
Three months forward		16/12
Three months interest rates		(per annum)
	$	1.60% – 2.00%
	Euro	2.80% – 3.00%

You are **required** to

a) Verify whether there is any scope for covered interest arbitrage.

b) Calculate the amount to be borrowed in order to make an arbitrage profit of $500, if there is scope for arbitrage. **13**

Q 4 A foreign institutional investor (FII) proposes to invest $10 million in an Indian security with a beta of 1.10 and standard deviation of returns 7%. The holding period of investment will be one year. The current rupee-dollar exchange rate is Rs.45.45 / $. The expected depreciation of rupee against dollar over the period is 2% with a standard deviation of 10%. The expected return from the market portfolio in India is 12% and the correlation between the return on security and the exchange rate is 0.50. The risk free rate of return in India is 5%.

You are **required** to calculate the expected return and risk for the FII. **13**

Q 5 If the forward premium deviates substantially from the interest rate differential, covered interest arbitrage is possible, says the Interest Rate Parity theorem. Briefly discuss why the Interest Rate Parity may not hold good in reality. **13**

Q 6 Discuss various kinds of internal hedging techniques. **13**

Q 7 Read the case and answer the questions given at the end.

It is important to pin point that even when foreigners are noisy and irrational, their activity does not necessarily have a destabilizing impact. Domestic investors may be powerful enough and the market as a whole concisely liquid to accommodate selling or buying pressures from noisy foreigners. As long as domestic investors are not subject to the same imperfections that give mount to noisy trading strategies, foreigners should have no impact on volatility. Nevertheless, they find no permanent effects of net foreign order imbalances on prices and volatility. Domestic investors very quickly accommodate large sales or purchases by foreign Investors.

One is that the relationship between volume and volatility is motivated by changes in fundamentals. If investors interpret information differently, new information will cause both price changes and trading. This gives rise to a contemporaneous connection between volatility and trading. Trading is the procedure through which private information is incorporated into prices. In this kind of case the causality runs from volatility to volume and markets are efficient.

The other option is that trading itself generates volatility in prices. Foreign trading is part and parcel of the total trading volume. Given that there is the positive relationship between total volume and volatility; anyone would expect that foreign trading is also associated with volatility. This relationship can denote two things. First and foremost is that it can reflect the heterogeneity within the group of foreign investors. This heterogeneity causes the information flow to about fundamentals to be associated with trading. Second thing is that it can mean that foreigners pursue noisy trading strategies and that their activity is not arbitraged away by domestic investors.

If the degree of heterogeneity among groups of foreign and domestic investors is the same then the two groups should exhibit proportional amounts of trading based on heterogeneity and fundamentals. Therefore, controlling for total trading volume, foreign trading should have no impact on volatility if foreign investors are as noisy as domestic. Nonetheless, if foreign investors are especially noisy and irrational, then even controlling for total trading volume their activity may have an impact on volatility. The relationship between trading volume and volatility is of some significance.

As on recent days total Investment of FII in India is apprx 1.5 lacs Crore and opposite to that Mutual funds investment is nearly 1.2 lacs crore, and in last three years gratitude to rally on Indices Mutual funds market has increased by whooping 30-40% and so as FII inflow. Except, only critical issue is if FII press selling button to book profit and to pump out their money in that event will household investors along with Mutual funds will save the grace for Indian Equity markets? This is the matter of question which is roaming in everyone's mind after Sensex and Nifty has corrected by whopping 12-13% in October itself, where net data shows FII were the sellers to the tune of Rs.2500 crore and opposite to that Mutual funds where buyers by Rs.1500 crore.

In this situation how Mutual funds role will be in coming months and time when market has become extremely hot-blooded is very interesting to investigate especially after SEBI has given permission to Mutual funds to trade in Derivatives markets and how Mutual funds will save Indian Indices to not behave in the mode as per FII Inflow and Outflow. These are all the possible questions can be answered after studding Behavior of Mutual funds in days to come.

Questions:

a) What recent developments have made India one of the favorite investment destinations for FIIs? Discuss. **9**

b) Discuss the various contributions of FIIs to the Indian economy. **9**

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