SIMON FRASER UNIVERSITY
Faculty of Business Administration
Final Examination

BUS 492
Securities Analysis

Rules for Submitting the Final Examination and the Project:

Answers to the final examination are to be typed, single spaced of length 3 total pages for both answers to Questions #1 and #2. The exam is to be submitted on 8.5"x11" paper, with 1" margin and type point of not less than 12. (This assignment is typed in 12 point.) For questions with multiple parts, answer all parts. Violations will be subject to deductions. The final examation and the project are due either in my office or my mailbox in the FBA office, **no later than** Monday, April 16, 2001. Deferred exam or project submissions must be personally approved by the instructor. If a project is not submitted by the deadline, it will be assumed that the student has taken the no paper option.

Marks Assigned: 50 points for each question

1. "Mean-variance analysis... has serious shortcomings that are too often ignored.... Perhaps the most serious defect is the poor out-of-sample performance of the optimal portfolios.... Another problem is the instability in the optimal portfolio: the proportions allocated to each asset are extremely sensitive to variations in expected returns, and adding a few observations may change the portfolio distribution completely. Also, optimal portfolios are not necessarily well diversified." (Jorion, 1985)

Comment on the implications of this statement for the management of both domestic and internationally diversified portfolios. In particular, be sure to address the implications of: different possible specifications of the optimization problem and different possible techniques for estimating the relevant parameters.

2. "The search for the 'correct' way to value common stocks, or even one that works, has occupied a huge amount of effort over a long period of time....the implementation of a system to selectively value or select common stocks is a difficult task. This is a task that a valuation model purports to accomplish."

Describe some of the discounted cash flow valuation models conventionally used to analyze common stocks. What are the limitations of these models? What is the appropriate accounting variable to use for the cash flow which is to be discounted?