

Problem Set 7
(Due Monday, May 3, 1999)

1. BM, Problem 1, Chapter 13 (p. 349)
2. BM, Problem 12, Chapter 13 (p. 350)
3. BM, Problem 13, Chapter 13 (p. 350)
4. If one could realize superior profits by buying stock of firms that have just announced unexpectedly large earnings, then there would be violation of which form of the market-efficiency hypothesis:
 - (a) the weak form
 - (b) the semi-strong form
 - (c) the strong form
 - (d) none of the above
5. **The Cost of Capital**

Canonica Inc. produces photographic equipment. It has a debt-equity ratio of 0.5. The beta of its stock is 1.30. Its bonds pay a semiannual coupon of 9% and have 3.5 years to maturity. The next coupon date is in 6 months. The bonds trade at 97% of par. Canonica's management considers building a new plant. Management assumes that the beta of this project is equal to the company beta. The riskless rate is 5% and the market risk premium is 7%. Determine the discount rate for the plant.
6. BM, Problem 6, Chapter 9 (p. 233). In part (c), assume that the riskless rate of interest is 5% and that the market risk premium is 6%.