

UNIVERSITY OF ROCHESTER

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Finance 411
Investments

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Spring 1997

Quiz # 3: April 23, 1997

1. (10 points)

Some of the largest one day returns to individual stocks occur when a tender offer or merger announcement is made (the average one day return for target firms is over 20 percent!) Accordingly, many security analysts have devoted resources to the problem of predicting which firms are likely to be the targets of takeover fights (e.g., local guru Charles LaLoggia used to run advertisements on CNN saying that he can successfully predict takeover targets, and hence earn abnormal returns). Given your knowledge of the theory and evidence concerning the efficient markets hypothesis, answer the following questions.

(a) If you are an avid reader of the *Wall Street Journal*, when is the best time to invest in takeover stocks? At the time the first offer is made? At the time when a second bidder enters the battle (if one does)? At the time when the firms agree to consummate the transaction (if they do so)? **Why?**

(b) Suppose you bought Mr. LaLoggia's newsletter, and suppose that he *is* able to predict takeover targets better than by throwing darts at the *WSJ*. Is it likely that you could earn abnormal returns by buying the stocks he predicts will be taken over? ***Why or why not?***

(c) Some arbitrageurs ('Arbs') have made a lot of money over the last decade by trading in stocks involved in takeover fights. Are these people earning abnormal returns? ***Why or why not?*** (*Hint: Ivan Boesky was one of the most famous of these Arbs*).