

UNIVERSITY OF ROCHESTER

William E. Simon Graduate School of Business Administration

Finance 411
Investments

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Quiz # 8: May 22, 1996

1. (10 points)

Amihud and Mendelson argue that liquidity is an important determinant of the demand for assets.

(a) Explain why security prices would be higher and expected rates of return lower if the cost of illiquidity could be reduced for an asset.

(b) Briefly summarize the evidence Amihud and Mendelson produce to support this hypothesis?

(c) What implications, if any, does the Amihud and Mendelson analysis have for portfolio theory (i.e., the way that different investors choose optimal portfolios of assets?) [*Hint: can you think of specific types of investors or investment accounts that would be more or less suitable for illiquid assets?*]

(d) How does it affect corporate finance (e.g., the types of securities that firms choose to sell to finance their activities?) [*Hint: what can a firm do to make its securities more liquid?*]