

NAME: _____

BEM 103 QUIZ 4

1. *Please define the Bid-Ask spread:* The difference between the highest bid (offer to buy) and lowest ask (offer to sell) for a particular security

2. *Please define a closed end fund :* A publicly traded investment opportunity, where a fund managers issues a fixed (hence closed end) number of shares to the fund and uses the shares to buy other securities. Investors who want to buy into (or sell out of) the fund must do so on the market. With other funds, investors send money to the fund which buys additional securities when it get inflows (or sells securities when it faces withdrawals).

3. *If a closed end fund trades below its net asset value (NAV) is that a violation of value additivity? :* Value additivity states that a composite security's value is the sum of the individual values. If a fund trades below its NAV it is trading below the sum of the securities it holds and that is a violation of value additivity.

4. *In the absence of transactions costs how would investors seeking arbitrage opportunities react to a closed end fund that trades at 80% of NAV.* _____

Answer 1: In the absence of transaction costs (the current price of the fund is what you can buy the whole of the fund for) someone should buy the closed end fund and liquidate it and thus secure the arbitrage opportunity.

Answer 2: even if there are no trading costs, supply curves slope up and it may still be impossible for an investor to buy up enough of the fund without raising share prices to the NAV and eliminating the arbitrage opportunity.

NOTE: 1 is technically correct, but two is acceptable.