Session 2: Post Class tests (Solutions)

1. c. An asset with uncertain cash flows over any time period. You cannot do intrinsic valuation on non-cash flow generating assets (collectibles, paintings, gold). An asset with contingent cash flows is best valued as an option.
2. d. An investor with a long time horizon that thinks that markets are wrong at points in time but that they correct themselves over time. If markets are always wrong, you will not make any money on your intrinsic valuation and you need a long time horizon to improve your odds of markets correcting themselves.
3. d. An asset that is similar to other assets, many of which are traded. You need similar assets for the comparison and the trading for the prices on these assets.
4. b. False. You may make fewer explicit assumptions but you ultimately make the remaining assumptions implicitly. Put differently, the number of assumption embedded in both approaches is the same, but you may make judgments on fewer of them.
5. b. Augmenting the value from a discounted cash flow model. An option pricing model is an add-on to an intrinsic valuation model, where you are willing to pay a premium over the discounted cash flow value for the optionality. That premium will be a function of the risk in the underlying asset and the characteristics of the option.