Financial Management Assignment

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*Answer 1*

There is no definite time limit in the perpetuity. If there is some time limit applied to it, it will turn into an ordinary annuity. The cash flows in case of perpetuity are assumed to continue for an indefinite period of time (CorporatefinanceInstitute, 2019). One more aspect is that the present values in case of perpetuity are too low and one cannot expect huge future values out of these. The principal amount in case of perpetuity is never repaid. Further, the perpetuity is assumed to be continued for an indefinite period of time which means that it will have no future value.

*Answer 2*

There are two different scenarios to consider in case of cash flows at different times. The amounts of cash flow can be the same at different points in time or there can be different amounts of cash flow at different points in time. Handling these scenarios require different tactics. The same amounts of cash flow at different times will be treated as an annuity and the annuity formula will be applied to calculate the present or future values as appropriat6e. If there are different amounts of cash flow at different points in time then all of them will have to be treated as separate amounts and the calculations will be done individually. The decision will be made by comparing the values at the same point in time. For example, two alternatives are given, one having a fixed stream of $ 400 for the next five years and the other stream offers $ 400 for year 1, $ 375 for year 2, and $ 440 for year 3, $ 425 for year 4 and $ 300 for year 5. In order to ascertain which option is better, we will have to calculate the present values of the amount at time 0. This will allow us to compare the two options and decide which option is better. Net present value is not the only option to analyze the various financial situations. One of these options is the internal rate of return (Arshad, 2012). The best way to figure out these kinds of problems is to compare the present values of amounts.

*Answer3*

In this situation, we will calculate the effective interest rates for both cases. In the first case, the compounding is done annually so the nominal interest rate will be the same as the effective interest rate. In the second case, the compounding period is monthly that shows that an effective rate of interest will be different from the nominal rate of interest. The conversion of nominal interest rate to an effective interest rate yields a value of 9.59%. This is lower than the percentage of the annual interest rate of 10% so the person should go for the second option (Kevin Bracker, n.d.).

*Answer4*

This is a scenario where the interest rate is compounded monthly and payments are made on a semi-annually basis. In this case, the process will take two steps to complete. Firstly the monthly interest rate will be converted to semiannual by dividing it by 6. In the second step, both these values will be converted to annual equivalents by dividing and multiplying by 2. In essence, we will have to bring both the values at the same time frame before converting them to annual equivalents (Irena & Mariana, 2017).

*Answer 5*

The nominal interest rate cannot be negative because that will mean that banks will pay the borrowers to borrow money from banks. If we consider the real interest rates, they can be negative in the scenario where the inflation rate is higher than the nominal interest rate (Moffatt, 2019).

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