

Finance 1 / Principles of Finance

FNCE10001 / FNCE10002

Note: Finance 1 rebranded as Principles of Finance in 2017

Semester 1: 2016

Holding Period Yield

- If security is sold before maturity
 - Actual yield will differ from yield to maturity
 - General measure of investment yield

$$r = \left(\frac{F \text{ or } P_{\text{sell}}}{P_{\text{buy}}} - 1 \right) \frac{diy}{d} \quad \text{or } F = P \left(1 + r \frac{d}{diy} \right)$$

- Held to maturity F would be used
- Sold before maturity P_{sell} would be used
- *diy* = days in the year
- *d* – days held or days to maturity depending on situation
- used to adjust annual rate

Annuities

- An investment that entitles the investor to a series of equal payments (R) made at equal time intervals
- Fixed rate of return
- Original investment is less than sum of all payments
 - accounts for depreciation in value of money over time

PVAF

- Present Value Annuity Factor, calculates the present value of the annuity, which will be less than the sum of all payments.

$$P = R \times PVAF \quad PVAF = \left[\frac{1 - \left(1 + \frac{r}{k} \right)^{-kt}}{\frac{r}{k}} \right]$$

R = value of equal repayment

r = rate of return

k = number of payments

t = time in years

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Payment System

Trading allocates resources and distributes goods and services. This requires an effective and reliable means of exchange, eg precious metals, legal tender, payment orders (cheques).

Payment Orders

- Facilitate payments by transferring funds from a drawers account to a depositors account between ADIs
 - Clearing involves the contractual process between the transfer where the banks agree on the terms of a transaction.
 - Settlement, the exchange of the value that completes the transaction.
- Direct Entry
 - Pre-authorised and verified orders that are processed electronically.
 - Allow organisations:
 - To make payments to large groups (direct credits, such as salary payments)
 - To receive payments from large groups (direct debits, such as loan repayments to ADIs)

Wholesale Payment System

- Large-value
 - Originate in the financial market with large corporate payments and from inter-ADI payments.
 - Instructions received from foreign exchange market, CHESS (wholesale share trades), RBA.
- Use Real-Time Gross Settlement (RTGS)
 - Settlements occur throughout the day with the transfer of exchange settlement, where each payment obligation is settled in full, rather than netted.
 - Intra-day liquidity is stressed through RTGS, hence RBA
 - queues arrangements to help banks with payment flow
 - offers repurchase agreements, that provide a bank with additional funds for part of the day as the RBA purchases government securities from the bank, on the agreement that the bank will purchase them back later that day.

Retail Payment System

- Small-value payments between small business and individuals
- Include
 - cash,
 - cheques
 - dated paper instruction to the drawers ADI to pay the stated party a sum.