



JARAMOGI OGINGA ODINGA UNIVERSITY OF SCIENCE AND TECHNOLOGY
SCHOOL OF BUSINESS & ECONOMICS
UNIVERSITY EXAMINATION FOR THE DEGREE OF BACHELOR OF BUSINESS
ADMINISTRATION
3RD YEAR 2ND SEMESTER 2016/2017 ACADEMIC YEAR
MAIN CAMPUS

COURSE CODE : ABA 318

COURSE TITLE : FINANCIAL INSTITUTIONS AND MARKETS

TIME: 2 HOURS

Instructions:

- 1. Answer Question ONE (COMPULSORY) and ANY other TWO questions**
- 2. Candidates are advised not to write on the question paper**
- 3. Candidates must hand in their answer booklets to the invigilator while in the examination room**

QUESTION ONE

- a.) Explain briefly how financial markets benefit the individual and the economy. (5 marks)
- b.) “In well-developed capital markets, a range of investors should have the same required return for the same asset.” Develop this argument in relation to Efficient Market Hypothesis (EMH) (10 marks)
- c.) Under what circumstances will you consider applying the following Dividend Growth Models to determine the price of stock?
- i.) $P_0 = \frac{D}{k_e}$
- ii.) $P_0 = \frac{D_1}{k_e - g}$ (5 marks)
- d.) “The risk premium on any asset is proportional to its beta coefficient.” Explain. (5 marks)
- e.) The market has an expected return of 15%, the riskless rate of interest is 5%, and a common stock has a beta of 2. Using CAPM, what is the expected rate of return on this stock? (5 marks)

QUESTION TWO

- a.) Briefly explain the general characteristics derivative securities. (5 marks)
- b.) Explain also the meanings of the below security derivatives, and how they are applied to the market.
- i.) Future contracts
 - ii.) Options
 - iii.) Swaps
- (15 marks)

QUESTION THREE

- a.) What are the circumstances under which premium, discount and par bond can successfully be offered in the bond market? (5 marks)
- b.) “Sometimes bond issue financing can prove a more effective way of financing long term investments”. Do you agree or not agree? Explain. (5 marks)
- c.) The AR & T bond with 7% p.a. coupon maturing after 10 years is offered to the market today at a face value of Kshs. 100,000/-. If investors can receive a 7.5% p.a. on similar bonds, what is the price this particular bond? (10 marks)

QUESTION FOUR

- a.) Suppose you can purchase a Kshs. 1 million Treasury bill that is currently selling on a discount basis at 97 ½ % of its face value. The T-Bill is 140 days from maturity. Required:
- a.) Calculate both the discount yield and the bond equivalent yield. (5 marks)
 - b.) Explain the following theories in regard to how they affect term structure of interest rates
 - i.) Market Segmentation Theory
 - ii.) Unbiased Expectations Theory
 - iii.) Liquidity Premium Theory
- (10 marks)

QUESTION FIVE

- a.) “The financial markets will not reward investors for risks that can be eliminated.” In your view, is this statement agreeable? Discuss. (10 marks)
- b.) An investor is thinking of investing in a stock which tends to do well in an expanding economy and very poorly in a recession. The possible returns are described as below:

State of the Economy	Returns	Probability	Forecasted
Economic Boom		0.50	40%
Normal Year		0.30	15%
Recessions		0.20	-30%

Required:

Calculate the expected return and standard deviation of this stock (10 marks)

