JARAMOGI OGINGA ODINGA UNIVERSITY OF SCIENCE AND TECHNOLOGY

SCHOOL OF BUSINESS & ECONOMICS

UNIVERSITY EXAMINATION FOR THE DEGREE OF BACHELOR OF BUSINESS ADMINISTRATION WITH IT

3RD YEAR 2ND SEMESTER 2016/2017 ACADEMIC YEAR

SPECIAL EXAM

COURSE CODE: ABA 320

COURSE TITLE: INVESTMENT AND PORTFOLIO MANAGEMENT

EXAM VENUE:LAB 1 **STREAM: BBA Fin.**

DATE: 05/05/16 **EXAM SESSION: 2.00 – 4.00 pm**

TIME: 2.00 HOURS

Instructions:

1. Answer Question ONE (COMPULSORY) and ANY other 2 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. Distinguish between systematic and unsystematic risk. [4marks]

b. Define the following: [4marks]

      i.   Interest rate risk factor

      ii.   Default risk factor

c. While financial statement analysis is an excellent tool, there are several issues to be aware of that can interfere with the interpretation of the analysis results. State three problems associated with financial statements analysis. [3marks]

d. Your rate of return expectation of the stock of KQ during next year are:-

Possible return	probability
-0.6	0.15
-0.3	0.1
-0.1	0.05
0.2	0.4
0.4	0.2
0.8	0.1

    i. Compute the E(R) on these stock, variance and standard deviation. [6marks]

    ii. Under what conditions can the Standard Deviation are used to measure the relative risk of two investments. [1mark]

    iii. Under what condition must the coefficient of variation be used to the relative risk of two investments. [1mark]

e. Security X returns depends on three factors; inflation, industrial production and aggregate degree of risk aversion. Given that R_f =8%. Required Rate of Return (RRR) on a portfolio with unit sensitivity of inflation at zero, sensitivity to other factors is 13.0%; RRR on a portfolio with unit sensitivity to industrial production at zero sensitivity to inflation and other factors is 10%. RRR on a portfolio with unit sensitivity to the degree of risk aversion at zero sensitivity to other factors is 6%. Security X has β_s of 0.9 with the inflation, 1.2 with industrial production and -0.7 with risk bearing portfolio (risk aversion). Assume that the Required Rate of Return on the market is 15% and stock X has CAPM $\beta = 1.1$

Required:

Compute security Xs Required Rate of Return using

a. CAPM   [2marks]
b. APT   [3marks]
f. An investor before buying bonds must evaluate a wide range of the factors which could influence his or her investment results. Identify and explain three financial ratios for the bond analysis.   [6marks]

QUESTION TWO
a. Identify and explain five features of bonds as a debt security.   [10marks]
b. Identify and explain five money market instruments.   [10marks]

QUESTION THREE
a. Identify and explain five sources risk.   [10marks]
b. Financial statements analysis may be very useful to interested parties. Identify and explain five users of such analysis.   [10marks]

QUESTION FOUR
a. State five characteristics of securities.   [5 marks]
b. The share of EABL is selling for Ksh. 104, Odhiambo buys a 3 month call option at a premium of Ksh. 5 the exercise price is Ksh. 105.
    i. What is Odhiambo's pay off if the share price is Ksh.100, Ksh.110, Ksh.115, Ksh.120 or Ksh.125at the time the option is exercised?   [10marks]
    ii. What is the pay off of the seller of the call option?   [5marks]

QUESTION FIVE
a. State five uses of derivatives by investors.   [5marks]
b. Briefly discuss typical examples of errors of judgments in behavioral finance. [15marks]