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KISUMU LEARNING CENTRE

UNIVERSITY EXAMINATION 2013/2014

ABA318:   FINANCIAL INSTITUTIONS AND MARKETS

INSTRUCTINS:

- **This question paper carries FIVE questions.**
- **Attempt THREE questions.**
- **Question ONE is compulsory.**

QUESTION ONE

a) How do interest rates for individual securities affected by the following factors:-**(10 mks**)

  i.   Inflation
  ii.   Real interest rates
  iii. Default risk
  iv.   Liquidity risks
  v.   Special covenants
  vi.   Maturity

b) Distinguish and explain these various interest rate measures.   **(10mks)**

  i.   Required rate of return
  ii.   Expected rate of return
  iii. Realized rate of return
  iv.   Coupon rate.

c) What is an of-balance-sheet activity by commercial banks? What are some examples and forces responsible for them?   **(5mks)**

d) A bank is considering two securities: 30 years Treasury bond yielding 7% and another 30 year yielding 5%.If the banks tax rate is 30%, which bond offers the higher tax equivalent yield? (**5mks)**

QUESTION TWO.

  a) Explain why bond financial could be attractive to both borrowers and investors (**10mks)**

b) What are the characteristics of the following bond issues?   **(5mks)**

  i.   Debentures
  ii.   Convertible bonds
  iii. Stock warrants
  iv.   Call provision

v. Junk bonds

c) A bond is listed to pay 10% coupon interest per year with the coupon paid semi annually. The bond matures in 12 years and has a face value of ksh 10,000/=.If the required rate of return is 8%, what is the fair market value of the bond? **(5mks)**

QUESTION THREE.

a) What are the general characteristics of money market instruments or securities? Explain also at least five of these instruments. (**5 mks)**

b) A bank enters a reverse repurchase agreement in which it agrees to buy treasury securities from one of its correspondent banks at a price of Ksh 10 million, with the promise to sell these securities back at a price of Ksh 10,008, 548 after five days. Calculate both the discount yield and the bond equivalent yield for the repurchase agreement. **(5 mks)**

QUESTION FOUR

a) Explain the difference between Stock Exchange and Stock Market indexes emhpasing on their importance to the functioning of secondary stock markets. **(5mks**)

b) What is market efficiency in relation to stock markets? Also explain the three measures commonly used to measure the degree of stock market efficiency. (**5mks**)

c) XYZ Corporation paid a dividend of Ksh of 3/50 at the end of last year. The company's dividends have grown at a constant rate of 2% for the last 20 years which is expected to be maintained into the future. The required rate return for the stock is 10%.Calculate the price of this stock. (**5mks**)

QUESTION FIVE

a) Explain the return derivative security. Why are derivative securities popular with institutions and individuals? (**5mks)**

b) Explain the following derivative market instruments. Provide examples of their applications.
(10mks)

  i. Futures
 ii. Options (call and put options)
iii. Swaps
 iv. Caps, Floors and Collars