KIMATHI UNIVERSITY COLLEGE OF TECHNOLOGY

STAGE TWO SEMESTER ONE EXAMINATION FOR THE BACHELOR OF COMMERCE

HPS 2307: INVESTMENT MANAGEMENT TIME: 2 HOURS

Instructions: Answer ALL questions.

Question One: (Compulsory)

(a) Financial assets generally experience variability of returns making potential investors to consider them risky. Explain any SIX factors that contribute to the total risk on a financial asset. (12 marks)

(b) Eugene Fama, a pioneer in efficient markets research described three levels of market efficiency.

i. What is the meaning of Market Efficiency? With illustrations from the local stock Exchange market, does the Market efficiency theory always hold? (6 marks)

ii. Explain the three levels of market efficiency. (6 marks)

(c) The following data relates to two stocks, A and B, which are currently trading in the local exchange market

	Stock A	Stock B
Return	0.1	0.06
Standard Deviation	0.05	0.04

If the correlation coefficient between the two stocks is -0.35, compute The risk of a portfolio consisting of 60% of stock A and 40% of stock B. (6 marks)

Question Two

(a) Harry Markowitz (1952) development the basic portfolio principles that underlie the modern portfolio theory which provides a framework of systematic construction of portfolios based on risk and return principles. Based on his arguments, explain:

The importance of covariance and the correlation coefficient (4 marks)

The impact of diversification on portfolio risk (4 marks)

(b) What is the Capital Asset Pricing model?Explain any SIX assumptions of the Capital Asset Pricing Model (8 marks)

(c) Differentiate between Systematic Risk and Unsystematic risk (4 marks)

Question Three

(a) Market anomalies are contrasts observed in the market that are observed in the market away from what would be expected in an efficient market. Explain any SIX market anomalies. (12 marks)

(b) with a suitable example in each case, give the differences between: (8 marks)

i. Marketable and non marketable financial assets

ii. Capital and Money market

iii. Direct and indirect investing

iv. Negotiable and Non negotiable instruments

Question Four

(a) XYZ industries has a beta of 1.45. The risk free rate is 8% and the expeted return on the portfolio is 13%.The company currently pays dividends at a rate of Sh 2.00 per share , and investors expect a growth in dividends of 10% per annum for many years to come.

i. What is the stock's required rate of return according to CAPM?

ii. What is the stocks market price per share, assuming this return?

iii. What would happen to the required return and to the market price per share if the beta was 0.8 (All other factors held constant?) (12 marks)

(b) What are Mutual funds? Give examples of and discuss the extent of participation by mutual funds in the investment arena in Kenya today (8 marks)

Question Five

(a) What is a derivative instrument? (2 marks)

(b) Briefly describe the following types of derivative instruments, and in each case bring out the distinguishing features in each category: (8 marks)

i. Forward contracts and future contracts

ii. Call options and Put Options

(c) Investors are often exposed to many risks, necessitating enhanced regulation and protection from abuses in the trading environment. Discuss the extent of investor protection in Kenya today. (10 marks)