



MASENO UNIVERSITY
UNIVERSITY EXAMINATIONS 2016/2017

**THIRD YEAR SECOND SEMESTER EXAMINATION
FOR THE DEGREE OF BACHELOR OF BUSINESS
ADMINISTRATION WITH INFORMATION TECHNOLOGY**

MAIN CAMPUS

ABA 320: INVESTMENTS AND PORTFOLIO MANAGEMENT

Date: 9th June, 2017

Time: 3.30 - 6.30pm

INSTRUCTIONS:

- Answer Question ONE and any other THREE.
- All questions carry equal marks
- Show all your workings
- Do not answer more than four questions



QUESTION ONE

a) Differentiate between an investor and a speculator (5 marks)

b) BBA. Ltd. is considering making an investment in one or both of two securities, A and B. The company seeks the advice of a financial analyst who gives the following data:

Security	Possible rates of return (%)	Probability of occurrence
A	30	0.3
	25	0.4
	20	0.3
B	50	0.2
	30	0.6
	10	0.2

Suppose the correlation coefficient between returns of A and B is 0.24.

Required:

Calculate the expected return, and standard deviation of each of the following portfolios:

- (i) 35 % A and 65 % B (6 marks)
- (ii) 10 % A and 90 % B (6 marks)

c) Differentiate between systematic and unsystematic risk. Illustrate this with the help of a diagram. (4 marks)

d) K & K Company Limited is planning to absorb three other companies so as to realize its sales records of Kshs.500, 000 per annum. Its accountants have advised the company to maintain such a size that it will enable its shares to sell at a minimum price of Kshs.16. The company's last published statement of financial position indicate the following:

	Kshs.'000'
Ordinary shares of Kshs.10 each	50,000
Reserves	65,000
Current liabilities	<u>40,000</u>
Total	<u>155,000</u>
Assets:	Kshs.
Fixed assets	80,000
Current assets	<u>75,000</u>
Total	<u>155,000</u>

Profits for the last 5 years were as follows:

	Kshs.'000'
1.	9,000
2.	6,000
3.	10,000
4.	8,000
5.	17,000

P/E ratio applicable is 12:1

Required: Compute the value of the business indicating the lowest offer price and the highest offer price and the share value thereof whether it would be viable to take on the three companies if it's to maintain this share value. **(4 marks)**

QUESTION TWO

- a) In relation to the real estate investments theory, explain the term sales comparison approach. **(2 marks)**
- b) Discuss the implications of efficient market hypothesis for investment policy as it relates to:
- i) Technical analysis **(4 marks)**
 - ii) Fundamental analysis **(4 marks)**
- c) BBA Ltd. is contemplating purchasing a 10 year bond worth Kshs 400,000 carrying a nominal coupon rate of interest of 12 %. BBA Ltd.'s required rate of return is 8 %. What should the company be willing to pay now to purchase the bond if it matures at par? **(3 marks)**
- d) A financial analyst has provided you with the following information relating to a call option:
- | | | |
|------------|---|----------|
| P | = | Kshs 20 |
| X | = | Kshs 20 |
| t | = | 3 months |
| K_{RF} | = | 12 % |
| δ^2 | = | 0.16 |
- Determine the value of the option. **(8 marks)**

QUESTION THREE

- (a) Explain the uses of the capital asset pricing model (CAPM) financial decisions of modern enterprise (5 marks)
- (b) The information provided below relates to an investor's portfolio comprising the shares of five companies quoted on the stock exchange.

Company	Beta	Market value of Investment (sh.)	Expected return
A Ltd.	0.6	200,000	14 %
B Ltd.	0.65	400,000	15 %
C Ltd.	0.6	100,000	13 %
D Ltd.	0.5	180,000	10 %
E Ltd.	0.75	120,000	21 %

The market return and risk free rate of return are 14.5 % and 9 % respectively.

Required:

- (i) Determine the portfolio's beta. (5 marks)
- (ii) Compute the expected return and the required rate of return of the portfolio (5 marks)

QUESTION FOUR

- a) In relation to investment management process, explain the steps used in the process highlighting the importance of each step in portfolio management process. (7 marks)
- b) Explain the difference between passive stock portfolio and active stock portfolio management approaches to security analysis. (2 marks)
- c) Assume that you are an administrator of a large pension fund and you are trying to decide whether to renew your contracts with your three money managers. You must measure how they have performed. Assume you have the following results for each individual's performance:

Investment Manager	Average Annual Rate of Return	Beta
Z	0.12	0.90
B	0.16	1.05
Y	0.18	1.2

Required: Calculate the Treynor's Measure for each investment manager and interpret the results. **(6 marks)**

QUESTION FIVE

- a) Explain any four factors that affect the valuation of real estate investments **(4 marks)**
b) The risk free rate is 15% and the expected rate of return on the market portfolio is 20%. The expected returns for four securities are listed below together with their expected betas:

Security	Expected Return	Expected beta
X	17%	1.2
Y	15%	0.8
Z	15.5%	1.1
C	17%	1.6

Required:

- i) With support of relevant computations, identify the securities that are over-valued and undervalued. **(6 marks)**
ii) If the risk free rate were to rise to 18% and the expected return on market portfolio rose to 24%, determine whether the securities will be over-valued and under-valued. **(5 marks)**