KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2017/2018

FIRST SEMESTER EXAMINATION FOR THE DEGREE OF

BACHELOR OF COMMERCE

BAC 408: APPLIED INVESTMENTS

DATE: Tuesday, 28th November 2017 **TIME: 8.00a.m-10.00a.m**

INSTRUCTIONS:

ANSWER ALL FOUR QUESTIONS

QUESTION ONE

a) An entrepreneur is considering a huge investment in the Soft drinks industry in Africa. Recommend *any five economic analysis factors* that he must have taken into account considering that she is keen on investing in Southern Africa as opposed to North Africa (5 marks)

b) Investment is bound to encounter financial risk. As a financial analysis, describe *hedging* in the context of investment risk management (2 marks)

c) Using appropriate examples, explain your understanding of *active versus passive portfolio management* (4 marks)

d) Considering your limited knowledge in capital markets, you access the services of a *Mutual fund* to achieve your objective of investing in securities. Discuss two key benefits of investing through *Mutual Funds* as opposed to investment in assets such as Land (5 marks)

e) Explain *four limitations* of the Capital Asset Pricing Model *(CAPM)* as an equilibrium asset pricing model in comparison to Arbitrage Pricing Model (APM) (4 marks)

QUESTION TWO

a) Consider a financial market with 3 possible investments which are shown below:

Probability	Asset X	Asset Y	Market Portfolio (M)
0.40	10%	12%	18%
0.20	8%	7%	15%
0.40	4%	(3%)	10%

The treasury bills pay 12% interest - this is an equivalent of the market portfolio. An investor is keen on investing in a portfolio of assets X and Y with 30% of the wealth being invested into asset Y.

i) Suppose the covariance between assets X and M is given as 1.05. Compute the *beta factor* for asset *X*

(4 marks)

ii) Discuss three key contributions of Markowitz (1952) in Portfolio Selection (3 marks)

b) Explain *any three benefits* of conducting *company analysis* before deciding on an investment option (3 marks)

c) Explain 2 reasons why Arbitrage Pricing Model/Theory (APM/APT) is considered a superior asset pricing model (5 marks)

d) Describe *systematic risk* and provide 2 examples of such a risk exposure (5 marks)

QUESTION THREE

a) Explain four *key features* of *true investment* as opposed to *speculation* (4 marks)

b) Consider the data below relating to several investments:

Security	Expected Returns	Standard Deviation	Beta Factor
A	7%	2.50	0.05
B	10%	3.55	1.50
C	8%	2.00	0.50
Treasury bills	6%	0.01	0.00
D	13%	2.10	1.15
Stock market index	12.5%	0.20	1.00

Advice Johnson on *the best investment strategy* using the Security Markets Line (SML)

(6 marks)

c) Explain the concept of *security market index* and highlight any 2 *benefits* of utilizing it

(5 marks)

QUESTION FOUR

a) Jane is Considering the 3 investments below. He finally opts for a portfolio containing X and Y with 40% of her wealth is to be invested into asset X:

Probability	Asset X	Asset Y	Market Portfolio
0.40	10%	12%	18%
0.20	8%	7%	15%
0.40	4%	(3%)	10%
Beta factor..............................	**1.30**	**1.75**	

The market pays a *12% return on risk-free assets*. Assume *a covariance of 1.40* between asset *X and Y.*

Required:

i) Compute the *Sharpe's Measure* and comment on the portfolio performance (5 marks)

ii) Compute the *Treynor's Measure* and comment on the portfolio performance (4 marks)

b) Highlight *six key factors* relating to *industry analysis* of an anticipated investment in the *transport industry* in a country such as *Kenya* (6 marks)