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**KIRIRI WOMEN'S UNIVERSITY OF SCIENCE AND TECHNOLOGY**  
**UNIVERSITY EXAMINATION, 2022/2023 ACADEMIC YEAR**  
**FIRST YEAR, FOURTH SEMESTER EXAMINATION**  
**FOR THE DIPLOMA IN ACCOUNTING**  
**DBF 1106: INVESTMENT ANALYSIS**

Date: 13<sup>TH</sup> DECEMBER 2022

Time: 11:30a.m- 1:30p.m

**INSTRUCTIONS TO CANDIDATES**

**ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER TWO QUESTIONS**

**QUESTION ONE (30 MARKS)**

- There are a number of investment instruments that investors can choose from. However, their choice of instruments or assets is largely determined by a number of factors. Highlight five of these factors. (5 marks)
- One of the methods of raising capital for a firm is through the issue of ordinary shares. Identify any five features unique to ordinary shares. (5 marks)
- When determining an asset's risk level, the beta is a commonly used measure. Highlight three applications of the beta measure. (6 marks)
- Benor Ltd, a publicly quoted company, intends to raise additional share capital through a rights issue. The number of issued ordinary shares currently stands at 100 million shares. Each shareholder will have a right to purchase one share for every five shares currently held. The current market price per share is Sh.60 while the rights price has been fixed at Sh.50 per share.

**Required:**

- Calculate the theoretical value of a right in Benor Ltd. (4 marks)
- Determine the theoretical ex-rights price of a share in the company. (4 marks)
- Advise Benor Ltd on the strategies to take to ensure their share price does not fall below the prevailing market price (6 marks)

**QUESTION TWO (20 MARKS)**

Eleanor has an investment capital of Sh. 1,000,000. She wishes to invest in two securities, A and B in the following proportion; Sh.200, 000 in securities A and Sh.800, 000 in security B.

The returns on these two securities depend on the state of the economy as shown below:

State of Economy	Probability	Returns on Security A	Returns on Security B
Boom	0.4	18%	24%
Normal	0.5	14%	22%
Recession	0.1	12%	21%

**Required:**

- Compute Eleanor's expected portfolio return. (6 marks)
- Calculate the portfolio risk. (8 marks)
- Calculate and interpret the correlation coefficient obtained from this information. (6 marks)

**QUESTION THREE (20 MARKS)**

- a) In the lead up to the full-blown pandemic currently been experienced, global financial markets were impacted to a large extent, mostly negatively. Identify and explain any five assumptions of efficient markets. (10 marks)
- b) Investors willing to undertake any investment opportunities are advised to adhere to the investment decision making process to avoid any potential and avoidable problems. Briefly explain the steps involved in this process. (10 marks)

**QUESTION FOUR (20 MARKS)**

- a) An analyst expects a risk-free return of 4.5% and market return of 14.5%. The returns for the stocks A and B are as shown below

Stock	Beta	Estimate Returns
A	1.2	16%
B	0.8	14%

Required;

- i. Draw and label a graph showing the security market line and position of stock A and stock B relative to it. (5 marks)
  - ii. State whether A and B are undervalued or overvalued and the actions to be recommended by the analyst. (5 marks)
- b) Security returns depend on only three risk factors-inflation, industrial production and the aggregate degree of risk aversion. The risk free rate is 8%, the required rate of return on a portfolio with unit sensitivity to inflation and zero-sensitivity to other factors is 13.0%, the required rate of return on a portfolio with unit sensitivity to industrial production and zero sensitivity to inflation and other factors is 10% and the required return on a portfolio with unit sensitivity to the degree of risk aversion and zero sensitivity to other factors is 6%. Security i has betas of 0.9 with the inflation portfolio, 1.2 with the industrial production and-0.7 with risk bearing portfolio— (risk aversion). Assume also that required rate of return on the market is 15% and stock i has CAPM beta of 1.1

Required: Compute security i's required rate of return using;

- i. CAPM (4 marks)
- ii. APT (6 marks)

**QUESTION FIVE (20 MARKS)**

- a)The Capital Asset Pricing Model is a descriptive model used to price financial assets. However, despite its success, it possesses some challenges which make it less ideal. Briefly explain the disadvantages of CAPM as an asset pricing model. (10 marks)
- b)Winton, a director at a manufacturing recently heard in the news that equipment leasing terms are now favorable to manufacturers due to COVID-19's impact on firms in the country. However, she is clueless about the different leases. As an investment analyst, discuss with her the differences between operating leases and finance leases and give her your opinion on which option you think she should choose. (10 marks)