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KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY
UNIVERSITY EXAMINATION, 2021/2022 ACADEMIC YEAR
FOR THE DIPLOMA IN BANKING AND FINANCING

UNIT CODE: DBF 1106

UNIT TITLE: INVESTMENT ANALYSIS

EXAM TYPE: MAIN EXAM

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INSTRUCTIONS TO CANDIDATES

ANSWER QUESTION ONE AND OTHER TWO FROM QUESTIONS ONE TO FIVE
BELOW

QUESTION IS COMPULSORY (30 MARKS)

- (a) Most researchers in the area of finance and investment agree that investment analysis is a comprehensive term. It encompasses a diversified range of computations and assessments that analyse market trends, investments and financial industries. It requires the analysts to apply a wide range of metrics including past returns, yield potential, price movement and other variables to guide investment decisions. As a student in the Investment Analysis class:
- i. Discuss the **FIVE** steps involved in making a sound investment decision (10marks)
 - ii. Advise on any **FIVE** common investment instruments that you can recommend to an investor in an emerging market economy who has been referred to you by one of your classmates in Investment Analysis class (05marks)

- (b) Data from Rigoma Securities Exchange Market indicates that the risk free rate of a return is 8%, the market expected rate of return is 12%. The standard deviation of the market return is 2% while the covariance of return for security A and the market is 2%. You are required to compute the required rate of return on a banana which is one of the commonly traded security there (09 marks)
- (c) Investors' attitude towards depends on a number of factors which eventually affects their attitude towards risk. Briefly discuss the **THREE** types of investors as relates to risk attitude (06 marks)

QUESTION TWO (20 MARKS)

A Security returns depend on only three riskfactors-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. **Using CAPM** (06 marks)
- II. **Using APT** (06 marks)

B. Briefly discuss **FOUR** assumptions of efficient capital markets (08marks)

QUESTION THREE (20 MARKS)

A. The Capital Asset Pricing Model (CAPM) is one of the commonly studied area in portfolio management owing to its attractive attributes including simplicity in computations. CAPM specifies the relationship between risk and required rate of return on assets when they are held in well-diversified portfolios. With all this in perspective, many critics in finance literature have resorted to an alternative

approach to CAPM especially in a multi factor market. Briefly discuss **FOUR** limitation of CAPM that have led to the alternative approach in asset pricing such as arbitrage pricing technique (08marks).

B. two investments, A and B are both traded at the Mobamba Securities Exchange Market each having the following investment characteristics;

<i>Investment</i>	<i>Expected Return (%)</i>	<i>Proportion</i>
A	10	2/3
B	20	1/3

REQUIRED:

Compute the expected return of a portfolio of the two assets (12marks).

QUESTION FOUR (20 MARKS)

A. Mary wishes to buy a commodity worth Kes. 1,100 today. The risk-free rate is 7% and she expects to hold it for a period of 6 months. 2 months after buying the contract, she notices that the spot rate has changed to Kes. 1,120 and that the risk-free rate has also changed to 8.5%. Determine whether she should sell the contract or continue holding onto it (12marks).

B. Literature from the financial literature has continued to advance the debate on efficiency of capital markets based on the land mark paper by the French man Fama and Fama, up to date there is no conclusive research on whether these markets really exist. However, the discussions in this area agree that market efficiency suggests that at any given time, prices fully reflect all available information on a particular stock or asset or market. With this concept in mind and in line with the knowledge gained from your Investment Analysis class:

- I. Define the term efficient capital markets (02marks)
- II. Discuss the **THREE** types of markets based on efficiency (06marks)

QUESTION FIVE (20 MARKS)

A. Several theories have been used to explain the shape of yield curve. Discuss such **THREE** theories (09marks)

- B. With examples in each case, explain any **FOUR** emerging issues in the investment platform in the current post COVID19 period (08marks)
- C. Identify any **THREE** investor institutions (03marks)