



MURANGA UNIVERSITY COLLEGE

(A constituent College of Jomo Kenyatta University of Agriculture & Technology)

MAIN CAMPUS

ORDINARY UNIVERSITY EXAMINATIONS

2015/2016 ACADEMIC YEAR

THIRD YEAR SECOND SEMESTER EXAMINATIONS

FOR THE DEGREE OF BACHELOR OF COMMERCE

COURSE CODE: HBF 2304

COURSE TITLE: INVESTMENT ANALYSIS AND PORTFOLIO
MANAGEMENT

DATE: 18TH April, 2016

TIME: 2 HOURS

INSTRUCTIONS TO CANDIDATES

- Question ONE (1) is compulsory
- Answer ANY OTHER TWO questions

MRUC observes ZERO tolerance to examination irregularities

This Paper Consists of 3 Printed Pages. Please Turn Over.



QUESTION ONE (COMPULSORY)

- a. What do you understand by the term 'investment'? (4 marks)
- b. Explain the difference between investments and speculation (10 marks)
- c. JF limited, a company located in murang'a road is considering a rights issue to finance an expansion of its operations. It is estimated that the expansion will cost sh. 1 million and the management has decided to finance it through rights issue of sh. 40 per share. Currently, the company shares are trading at sh. 60 at the stock market and the company has 100000 ordinary shares outstanding.

Required:

- i. Compute the theoretical ex-right price of shares (4 marks)
- ii. What is the theoretical value of the rights (3 marks)
- iii. Evaluate the effect of the rights on Kamau who holds 60 shares in the firm and had sh. 600 in absolute wealth just before the rights issue and exercised the rights (5 marks)
- d. Differentiate between European and American options (4 marks)

QUESTION TWO

- a. Efficient market hypothesis (EMH) has implications on investment decisions which given rise to two investment strategies. Explain these strategies (10 marks)
- b. Making reference to Markowitz Mean-Variance concept of efficient frontier, when is a portfolio said to be inefficient (3 marks)
- c. What steps are involved in portfolio selection as prescribed by the separation theorem (3 marks)
- d. Return on a typical financial investment normally consists of two components. Identify and explain these components (4 marks)

QUESTION THREE

- a. Portfolio management process is a systematic process involving a number of steps. Sequentially identify these steps (7 marks)

- b. Duration is usually not a good measure of bond interest rate sensitivity; why is this the case (3 marks)
- c. An investor holds a 10 percent 8 year Sh. 40,000 par value convertible bond. It has been established that the conversion price is Sh. 200 and the investors required rate of return is 12 percent. The common stock of the company is currently trading at sh. 260
- i. Using appropriate methods, advise the investor whether she can convert (5 marks)
- ii. Compute the value of the bond at the date of conversion (5 marks)

QUESTION FOUR

- a. You have been provided with two securities Q and G whose returns under different economic conditions are given below;

Economic state	Probability of occurrence	Returns [%]	
		Q	G
A	0.15	25	-15
B	0.2	20	10
C	0.25	15	20
D	0.1	10	25
E	0.3	-5	20

Determine:

- i. The risk and return of the individual assets (8 marks)
- ii. The risk of the optimum portfolio consisting of Q and G (10 marks)
- b. Under what circumstances is it possible to diversify virtually all systematic risk (2 marks)