



MURANGA UNIVERSITY COLLEGE

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

MAIN CAMPUS

SPECIAL / SUPPLEMENTARY 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: ----- April, 2016

TIME:

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. Explain the main features that characterize a bond (10 marks)
- b. Modern portfolio theory is one of the earliest attempts to quantify risk in an investment. On what assumptions is this theory based upon? (7 marks)
- c. Using a well labelled diagram, to show the relationship between risk and return, explain the benefit of diversification in the context of risk (6 marks)
- d. Differentiate between American and European options (4 marks)
- e. What steps are involved in portfolio selection as prescribed by the separation theorem (3 marks)

QUESTION TWO

- a. A portfolio consists of three securities A, B and C with the following parameters

Security (weight)	A (0.32)	B (0.38)	C (0.30)	Correlation Coefficient
Expected Returns (%)	20	15	10	
Standard deviation (%)	11	9	7	
$\rho_{A,B}$				-0.9
$\rho_{B,C}$				-0.7
$\rho_{A,C}$				0.4

- i. Determine the return of the portfolio formed by the three securities (4 marks)
- ii. Calculate the risk of return of the portfolio formed by the three securities (6 marks)
- b. Investments and speculations are commonly but erroneously used to refer to the same thing. Differentiate between the two (4 marks)

QUESTION THREE

- a. Highlight the various assumption that inform Capital Asset Pricing Model as a tool for investment management (6 marks)
- b. An investor holds a 10%, 15 years sh. 50000 par value convertible bond. It has been established that the conversion price is sh. 250. The investor's rate of return is 15% and the common stock is currently trading at sh. 280

Required:

- i. Using appropriate methods, advise the investor on whether or not to convert (6 marks)
 - ii. Compute the value of the bond at the date of conversion (4 marks)
- c. How is gambling different from investment and speculation (4 marks)

QUESTION FOUR

- a. A bond sh. 400000, 8% coupon bond matures in 4 years and its yield to maturity has been established at 12%.
- i. Compute the bonds duration (4 marks)
 - ii. If interest rates increased by 1 percent, what is this bond's sensitivity considering convexity (6 marks)
- b. Differentiate between active and passive investment portfolio management strategy (6 marks)
- c. A company paid a dividend of Sh. 50 per share last year. An investor whose required rate of return is 10 percent is interested in this stock.
- i. Compute the value of this stock for the investor (2 marks)
 - ii. Assuming a 5 percent normal growth rate, what would be the value of the stock (2 marks)