



# **MURANG'A UNIVERSITY OF TECHNOLOGY**

## **SCHOOL OF BUSINESS AND ECONOMICS**

### **DEPARTMENT OF COMMERCE**

#### **UNIVERSITY ORDINARY EXAMINATION**

**2017/2018 ACADEMIC YEAR**

**THIRD YEAR FIRST SEMESTER EXAMINATION FOR THE BACHELOR OF  
COMMERCE (FINANCE OPTION).**

**BCF302 – FINANCIAL ECONOMICS**

**DURATION: 2 HOURS**

**DATE: 8<sup>TH</sup> DECEMBER, 2017**

**TIME: 2.00- 4.00 P.M.**

#### **Instructions to Candidates:**

1. Answer **Question 1** and **Any Other Two** questions.
2. Mobile phones are not allowed in the examination room.
3. You are not allowed to write on this examination question paper.

## SECTION ONE - COMPULSORY

### QUESTION ONE

- (a) The Central bank can be said to have various kinds of functions. Discuss five ways that influences the Economy. (10 marks)
- (b) The information provided below relates to investors portfolios comprising the shares of 5 companies quoted on the stock exchange.

| Companies (Ltd). | Beta | Mrkt. value of investments | Expected Returns | Weights |
|------------------|------|----------------------------|------------------|---------|
| A                | 0.6  | 200,000                    | 14%              | 0.2     |
| B                | 0.65 | 400,000                    | 15%              | 0.4     |
| C                | 0.6  | 100,000                    | 13%              | 0.1     |
| D                | 0.5  | 180,000                    | 10%              | 0.18    |
| E                | 0.75 | 120,000                    | 21%              | 0.12    |

The market return and risk free rate of return are 14% and 10% respectively.

#### Required.

- Determine the portfolio Beta. (3 marks)
- Compute the expected rate of return of the portfolio. (5 marks)
- Compute the required rate of return of portfolio. (2 marks)
- Calculate the required rate of return for each of the shares above and state whether it is overvalued or undervalued. (10 marks)

## SECTION TWO – ANSWER ANY TWO QUESTIONS

### QUESTION TWO

- a) Discuss five importance of consolidation in the Capital market. (10 marks)
- b) Financial Inclusion is linked to Social Economic Development, and it faces some challenges. Explain five challenges. (10 marks)

### QUESTION THREE.

- (a) An investor has an investment fund of Shs. 2, 00,000. She intend's to apportion this fund into two securities X and Y as follows. 1.2 million in security X and 800,000 in security Y. The return on each security is dependent in the state of economy as shown below;

| <b>State of Economy</b> | <b>Probability</b> | <b>Return on Y</b> | <b>Return on X</b> |
|-------------------------|--------------------|--------------------|--------------------|
| Boom                    | 0.2                | 15%                | 20%                |
| Normal                  | 0.5                | 12%                | 18%                |
| Depressed               | 0.3                | 8%                 | 25%                |

**Required**

- i. Expected return on the Portfolio. (4 marks)
- ii. Standard deviation for each security. (4 marks)
- iii. Correlation coefficient between security X and Y. (8 marks)
- iv. Briefly explain what you understand by an efficient portfolio. (4 marks)

**QUESTION FOUR**

- (a) Stock exchange plays an important role in an economy. Explain five importance of stock exchange. (10 marks)
- (b) Monetary policy is operated by the Central Bank through the instrument of Credit Control. Discuss five Instruments. (10 marks)