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FACULTY OF EDUCATION AND SOCIAL SCIENCE

UNIVERSITY REGULAR EXAMINATIONS

DEPARTMENT OF BUSINESS STUDIES

2013/2014 ACADEMIC YEAR

1ST YEAR 2ND SEMESTER EXAMINATIONS

FOR THE DIPLOMA IN COMMERCE

COURSE CODE: DBF 103

COURSE TITLE: INVESTMENT MANAGEMENT

DATE: 14TH APRIL, 2014 TIME 2:00P.M. – 4:00P.M.

INSTRUCTIONS TO CANDIDATES

Answer ALL questions in Section A and any Three Questions in Section B

SECTION A

QUESTION ONE

Explain what is meant by risk premium and briefly explain any four sources of risk.

(10mks)

QUESTION TWO

The table below provides a probability distribution for the returns on stocks X and Y

State	Probability	Return on Stock X	Return on Stock Y
Depression	10%	5%	50%
Recovery	40%	10%	30%
Boom	30%	15%	20%
Recession	20%	20%	-10%

Required:

(a) Compute the expected on each of the stocks and interpret your answer (4mks)

(b) Calculate the standard deviation of each stock and interpret your answer (6mks)

(c) Calculate the expected return on a portfolio comprised of 60% of stock x and 40% stock Y (5mks)

SECTION B

QUESTION THREE

(a) Explain any two types of financial statements that are maintained by an organization clearly highlighting its roles (6mks)

(b) The top part of Dandora limited's 2012 and 2013 balance sheets are listed below (in millions of shillings.)

Current assets	**2008**	**2009**	**Current liabilities**	**2008**	**2009**
Cash and marketable			Accrued wages and taxes	28	29
Securities	25	30			
Accounts receivable	85	94	Accounts payable	55	61
Inventory	120	131	Notes payable	50	55
Total	**230**	**255**	**Total**	**133**	**145**

Calculate the current ratio and Quick ratio for 2012 and 2013 and give a brief description about the organizations liquidity position. (9mks)

QUESTION FOUR

(a) Explain the following terminologies (6mks)

(i) Systematic risk

(ii) Market portfolio

(iii) Risk free rate

(b) List and explain the THREE forms of efficient market Hypothesis (9mks)

QUESTION FIVE

Calculate the required return on the following stocks given that the risk-free rate is 9% and explain whether a rational investor would invest in the particular stock.

stock	**Beta**	**Expected return on market portfolio**	**Current rate of return**
A	2	12%	14%
B	1.5	11%	13.5%
C	1	15%	16%
D	1.2	14%	15%
E	0.5	13%	10%

(15mks)

QUESTION SIX

(a) Wafula intends to invest in 8% stock whose par value is Kshs.1,000/= each. The stock is redeemable after 5 years. The cost of capital is 10% p.a. Advice Wafula on whether to buy the stock if it is currently selling at Ksh.880.

(b) Would your advice to Wafula in (a) above be different if the 8% stock was to be held in perpetuity? (5mks)

(c) Determine the value of an ordinary share whose current dividend is Kshs.20/=. The par value of the share is Kshs.250/=. The share is expected to have a growth rate of 5% for the first 3 years, 4% in the following 2 years and 6% thereafter. The cost of capital is estimated to be 12% p.a.

(5mks)

QUESTION SEVEN

Explain any THREE types of derivatives (15mks)