MACHAKOS UNIVERSITY

University Examinations for 2019/2020 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING BANKING AND FINANCE

SECOND YEAR SECOND SEMESTER EXAMINATION FOR

BACHELOR OF ECONOMICS AND STATISTICS

BACHELOR OF ECONOMICS AND FINANCE

BACHELOR OF ECONOMICS

BACHELOR OF COMMERCE

EAE 202: FINANCIAL INSTRUMENT AND RISK MANAGEMENT

DATE: 30/11/2020 **TIME: 8.30-10.30 AM**

INSTRUCTIONS:

Answer question one and any other two questions.

QUESTION ONE (30 MARKS)

a) Financial instruments are financial contracts of different nature made between financial institutions in Kenya. In your own words, briefly discuss

  i. The meaning of a financial instrument (2 marks)

  ii. Explain and give three examples of financial instruments (4 marks)

b) A derivative is an important financial instrument. You are required to:

  i. Explain a derivative in a financial context (4 marks)

  ii. Explain three types of derivatives in Kenya's financial system. (6 marks)

c) i Describe the concept of risk management in financial institutions. (4 marks)

  ii Explain the meaning of hedging as a means of risk management. (4 marks)

  iii Explain four reasons why a financial institution should use hedging as a risk management tool. (6 marks)

QUESTION TWO (20 MARKS)

a) Explain four reasons why a company should invest in Bonds (8 marks)

b) Describe four possible risks in bond trading (12 marks)

QUESTION THREE (20 MARKS)

a) Briefly describe the portfolio theory (2 marks)

b) According to Markowitz Model, selection of any portfolio is based on several tools. You are required to mention and explain at least three of these tools (6 marks)

c) Differentiate and contrast:

   i. Modern Portfolio Analysis (6 marks)

   ii. Traditional Portfolio Analysis (6 marks)

QUESTION FOUR (20 MARKS)

a) Describe the following terms:

   i. Financial assets (2 marks)

   ii. Financial liabilities (2 marks)

   iii. Equity instrument (2 marks)

b) Calculate the dividend yield if company is expected to pay Sh.6 per share and quoted price is Sh.80 and expected price after one year is Sh.100 (6 marks)

c) Explain the CAPM model (4 marks)

d) Discuss arbitrage pricing theory (4 marks)

QUESTION FIVE (20 MARKS)

a) A company buys 1200 futures at Sh.250each under delivery-based settlement. On the day of expiry, the futures were actually priced at Sh.280.

   You are required to calculate the results of the company in terms of profit**.** (10 marks)

b) An investor buys a 10 year $10,000, 8% coupon, semiannual pay bond for $9,100. He sells it four years later, just after receiving the eighth coupon payment, when its yield to maturity is 5.6%. What would be the bond price at the time of sale? (10 marks)