



MACHAKOS UNIVERSITY

University Examinations for 2020/2021 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

SECOND YEAR SPECIAL/SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF ECONOMICS AND STATISTICS

BACHELOR OF ECONOMICS

EAE 202: FINANCIAL INSTRUMENTS & RISK MANAGEMENT

DATE: 25/3/2021

TIME:8.30-10.30 AM

INSTRUCTIONS:

- (i) Answer question one (Compulsory) and any other two questions
- (ii) Do not write on the question paper
- (iii) Show your working clearly

QUESTION ONE (Compulsory) (30 MARKS)

- a) Although similar in nature, forwards and futures exhibit some fundamental differences in the organization and the contract characteristics. Discuss the most important differences between the two. (10 marks)
- b) Consider a 5% 1 year to maturity coupon bond with a face value of Ksh 1000. If the price of the bond is Ksh. 800, what is the yield to maturity? (3 marks)
- c) Briefly discuss the various categories of risks faced by financial institutions. (5 marks)
- d) What role do financial institutions play in the Kenyan economy? (4 marks)
- e) Financial assets are characterized by various attributes. Explain them as clearly as possible. (8 marks)

QUESTION TWO (20 MARKS)

- a) i Equities(E) and bonds(B) are the basic financial instruments and both are considered as risky instruments. If ksh. 120,400 is invested in Equities and ksh.90,600 is invested in bonds. What is the weight of E& B in a complete portfolio? (3 marks)
- ii Suppose the owner of these portfolio wishes reduces the risky portfolio to 0.43, what will be the value of the non-risky portfolio and the risky portfolio? (4 marks)
- b) There are various types of financial markets operational in the Kenyan Economy. Discuss this statement. (9 marks)
- c) Which factors can affect the value of an option contract? (4 marks)

QUESTION THREE (20 MARKS)

- a) Define the following terms as used in finance:
- i. Arbitrage
 - ii. Securities
 - iii. Covenants (6 marks)
- b) Distinguish between the following pair of terms (6 marks)
- i. American Option and European Option
 - ii. Bearish option and Bullish option
 - iii. Primary and secondary market
- c) Explain factors that shift the bond demand curve (8 marks)

QUESTION FOUR (20 MARKS)

- a) Explain what you understand by the term 'Bond pricing' and discuss the various ways in which different types of bonds are priced. (14 marks)
- b) With examples, highlight the main uses of financial instruments. (6 marks)

QUESTION FIVE (20 MARKS)

- a) Preference shares can be equity and can be debt. Explain the key features that makes it a hybrid financial asset. (10 marks)

- b) Most businesses need to raise funds to expand their operations. The two main ways of doing this are by issuing either debt or equity which are the basic financial instruments. Explain other financial instruments that an investor can use to raise funds. (10 marks)