

BEAM031/BEFM013

UNIVERSITY OF EXETER
BUSINESS SCHOOL

JANUARY 2009

**FINANCIAL INSTRUMENTS
INVESTMENT INSTRUMENTS**

Module Convener: C. Lavers

Duration: ONE HOUR 30 MINUTES

Answer THREE out of FIVE questions

Use a separate answer booklet for each question

All questions carry 100 marks

Approved calculators are permitted.

This is a closed note paper.

Question 1

- a (i) An investor has just purchased £40,000 worth of equity which is currently selling for £80 per share. The investor could pay using 100% cash or use leverage. If using leverage, the investor has an initial margin requirement of 70%.

Show the investor's return if the stock rises to £90 per share and if it declines to £50 per share using,

- (1) cash
- (2) maximum leverage.

Ignore taxes and transaction costs.

(40 marks)

- a (ii) Distinguish a 'maintenance margin' from an 'initial margin' with respect to share purchases.

(15 marks)

- b What is the 'cyclical indicator' approach to forecasting the overall level of economic activity? When using this approach, detail the primary indicators used to predict future economic conditions.

(45 marks)

(Total 100 marks)

Question 2

- a. You have a portfolio consisting of two bonds, Bond A and Bond B. You have £250,000,000 invested in Bond A, which is a 1 year 5% bond, with a price which is £80 per £100 nominal. You also have £300,000,000 invested in Bond B which is a 2 year 7% bond, with a price of £100 per £100 nominal. Calculate the yield and duration of this portfolio.

Assume that coupons are paid annually.

Hint: The portfolio's yield lies between 10% and 20%.

(40 marks)

- b. What does duration tell us about a bond, and what are the limitations of using duration?

(30 marks)

- c. Giving examples, explain what is meant by 'alternative investments'. Why might an investor consider including 'alternative investments' in their portfolio, and what might limit their attractiveness?

(30 marks)

(Total 100 marks)

Question 3

- a Explain the general rationale that underlies technical analysis.
(20 marks)
- b Outline three technical trading rules, or methods, used by chartists to forecast the future performance of a share, and explain the share price expectation (and investment decision) following each pattern.
(30 marks)
- c Discuss the empirical evidence regarding the usefulness of technical analysis as the basis for stock selection.
(50 marks)
- (Total 100 marks)

Question 4

Based upon the Bank of England's Financial Stability Reports (October 2007 and October 2008) outline the causes and consequences of the 'credit crunch'.

(100 marks)

Question 5

- a. Outline the differences between futures and forward contracts.
(25 marks)
- b. Describe three alternative methods of valuing Real Estate.
(20 marks)
- c. As a portfolio manager developing an investment policy statement for a client, what possible client constraints must you consider?
(25 marks)
- d. Outline two methods for choosing a hedge ratio. How can one determine the effectiveness of a hedge?
(30 marks)
- (Total 100 marks)

End of Paper