(38)

(Knowledge for Development)

KIBABII UNIVERSITY

UNIVERSITY EXAMINATIONS

2019/2020 ACADEMIC YEAR

THIRD YEAR SECOND SEMESTER

SPECIAL/SUPPLEMENTARY EXAMINATION

FOR THE DEGREE OF BACHELOR OF COMMERCE

COURSE CODE : BCF 336

COURSE TITLE : FINANCIAL RISK MANAGEMENT

DATE: 8TH FEBRUARY,2021 TIME: 2.00PM – 4.00PM

INSTRUCTIONS TO CANDIDATES

Answer Question One in Section A and Any other TWO (2) Questions in Section B

TIME: 2 HOURS

KIBU observes ZERO tolerance to examination cheating

This Paper Consists of 2 Printed Pages. Please Turn Over.

QUESTION ONE.

(a) What is the Capital Market Line? How does it differ from the Security Market Line? **(6 Marks).**

(b) Assuming a risk free rate of 10 percent. The Market portfolio is expected to yield a return of 20 percent with a standard deviation of 8 percent.

Required.

Calculate the proportion in which an investor should combine the market portfolio and risk free security in order to earn an expected return of 16 percent. **(6 Marks).**

(c) Discuss the various risks facing financial institutions. **(10 Marks).**

(d) Consider a forward contract on a non dividend paying stock/share with the following characteristics:

Maturity	-	10 months
Share Price	-	Shs 80
Risk free rate of interest	-	14 percent (continuously compounded).

Required.

(i) Calculate the forward rate. - **(4 marks).**

(ii) Calculate the forward rate if maturity is 11 months. - **(4 Marks).**

QUESTION TWO.

Write short notes on the following:

(a) Limitations of CAPM. - **(5 Marks).**

(b) Swap Contracts. - **(5 Marks).**

(c) Limitations of forward contracts. - **(5 Marks).**

(d) Implications of financial risk. - **(5 Marks).**

QUESTION THREE.

(a) The returns of two assets under possible states of nature are given below:

State of Nature	Probability	Return on Asset 1	Return on Asset 2
1	0.25	20%	-12%
2	0.35	15%	10%
3	0.15	30%	40%
4	0.25	12%	20%

Required.

Calculate the following:

(i) Standard deviation - **(6 Marks).**

(ii) The Covariance between the two assets. - **(6 Marks).**

(iii)The coefficient of correlation between the two assets. - **(6 Marks).**

(b) Which of the two assets is financially desirable and why? - **(2 Marks).**

QUESTION FOUR.

(a) Distinguish between Translation and Economic currency risk exposures. **(8 Marks).**

(b) Explain how Multi-National Companies deal with both of these risk exposures. **(12 Marks).**

QUESTION FIVE.

(a) Explain the meaning of Capital Asset Pricing Model and also highlight its assumptions. **(8 Marks).**

(b) XYZ Ltd has a beta of 1.10.The risk-free rate is 10 percent and the expected return on the market portfolio is 15 percent. The company presently pays a dividend of Shs 3 per share and investors expect it to experience a growth in dividends of 8 percent per annum for many years to come.

Required.

(i) What is the stock's required rate of return according to CAPM? - **(4 Marks).**

(ii) What is the stock's present market price per share, assuming this required return? **(4 Marks).**

(iii) What would happen to the required return and to market price per share if the beta were 1.20 (assuming that everything else stays the same)? **(4 Marks).**