

KASNEB

CIFA PART I SECTION 2

FINANCIAL INSTITUTIONS AND MARKETS

TUESDAY: 24 November 2015.

Time Allowed: 3 hours.

Answer any FIVE questions.

ALL questions carry equal marks.

QUESTION ONE

- (a) (i) Define the term "financial repression" as used in the financial sector. (2 marks)
- (ii) Summarise four consequences of financial repression in the economy of your country. (4 marks)
- (b) Outline four ways that could be used to minimise bank runs in the economy. (4 marks)
- (c) Discuss five hypotheses that could lead to underpricing of initial public offering (IPO). (10 marks)
- (Total: 20 marks)

QUESTION TWO

- (a) (i) Define the term "dark pools" as used in financial markets. (2 marks)
- (ii) Explain two advantages of dark pools in the financial markets. (4 marks)
- (b) Discuss seven characteristics of informal financial markets. (14 marks)
- (Total: 20 marks)

QUESTION THREE

- (a) The following information relates to stocks X, Y and Z on 1 July 2014:

Stock	Number of shares	Price (Sh.)
X	60,000	30
Y	200,000	25
Z	90,000	65

During the year, stock X undertook a reverse stock split of one for two. On 1 July 2015, the prices of stocks X, Y and Z were Sh.40, Sh.35 and Sh.70 respectively.

Required:

- (i) Construct a price weighted index for the three stocks and compute the percentage change in the index. (4 marks)
- (ii) Construct a value weighted index for the three stocks and compute the percentage change in the index. (4 marks)
- (b) Discuss three basic types of market anomalies. (12 marks)
- (Total: 20 marks)

QUESTION FOUR

- (a) James Katana operates a margin account and has deposited Sh.1,000,000 in the account. The prevailing margin requirement is 50%. James decides to buy SML Limited's stock selling at Sh.50 per share.

Required:

- James Katana's profit (loss), if SML Limited's stock price falls to Sh.40 per share. Ignore commission. (4 marks)
- (b) Explain the following terms as used in behavioural finance:
- (i) Home bias. (2 marks)
- (ii) Overconfidence bias. (2 marks)

- (iii) Self attribution bias. (2 marks)
 - (iv) Regret avoidance bias. (2 marks)
 - (c) Describe four types of fees charged to unit trust investors. (8 marks)
- (Total: 20 marks)**

QUESTION FIVE

- (a) (i) Define the term “financial exclusion” as applied in financial markets. (1 mark)
- (ii) Highlight three costs faced by investors for exclusion from financial services. (3 marks)
- (b) You have been appointed as the Financial Services Manager of Kalahari Limited. Your main duty is preparing the financial services marketing strategy for the company.

Required:

Analyse four factors that you would consider when preparing the financial services marketing strategy. (8 marks)

- (c) An investor is reviewing with his broker the execution of a ticket to sell 1,000 shares of XYZ company. The ticket was split into three trades, A, B and C executed in a single day as follows:

- A. A market order to sell 200 shares was executed at a price of Sh.10.15. The quote that was in effect at the time was as follows:

Ask Price	Ask Size	Bid Price	Bid Size
Sh.10.25	200	Sh.10.10	300

- B. A market order to sell 300 shares was executed at a price of Sh.10.10. The quote that was in effect at the time was as follows:

Ask Price	Ask Size	Bid Price	Bid Size
Sh.10.20	200	Sh.10.10	300

- C. A market order to sell 500 shares was executed at an average price of Sh.10.00. The quote that was in effect at the time was as follows:

Ask Price	Ask Size	Bid Price	Bid Size
Sh.10.20	200	Sh.10.05	300

Required:

- (i) The average quoted spread for the stock of the day. (4 marks)
- (ii) The average effective spread for the stock of the day. (4 marks)

(Total: 20 marks)

QUESTION SIX

- (a) Describe four ways in which market psychology could influence the foreign exchange market. (8 marks)
- (b) A market has the following limit orders standing on its book for a particular stock:

Buyer	Bid Size (Number of shares)	Limit Price (Sh.)	Offer Size (Number of shares)	Seller
A	1,000	19.70		
B	200	19.85		
C	400	19.90		
D	300	20.00		
		20.05	800	E
		20.10	1,100	F
		20.15	400	G

A trader submits a day order to sell 1,000 shares, limit price of 19.85. Assume that no more buy orders are submitted on that day after the trader submits his order.

Required:

The trader's average trade size.

(6 marks)

- (c) Discuss three hedge fund investment styles.

(6 marks)

(Total: 20 marks)

QUESTION SEVEN

- (a) Describe five uses of repurchase agreement.

(10 marks)

- (b) Fred Nyale opened a margin account with Pixel Stock Brokers. Fred's initial investment was to purchase 2,000 shares of XYZ Limited on margin at Sh.40 per share. Fred borrowed Sh.30,000 from Pixel Stock Brokers to complete the transaction.

Required:

- (i) Actual margin in Fred Nyale's account at the time of share purchase.

(3 marks)

- (ii) Actual margin in Fred Nyale's account, if XYZ Limited reduces its share price to Sh.25 per share.

(3 marks)

- (c) Highlight four factors that might affect the size of the bid-ask spread for equity securities.

(4 marks)

(Total: 20 marks)

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