

**INSTITUTE OF BANKERS IN MALAWI**

**DIPLOMA IN BANKING EXAMINATION**

**SUBJECT: FINANCIAL MAKRETS 1 (IOBM – D203)**

**Date: Thursday, 15th November 2018**

**Time Allocated: 3 hours (13:30 – 16:30 Hours)**

**INSTRUCTIONS TO CANDIDATES**

1 This paper consists of **TWO** Sections, A and B.

2 Section A consists of 4 questions, each question carries 15 marks.

Answer **ALL** questions.

3 Section B consists of 4 questions, each question carries 20 marks. Answer **ANY TWO** questions.

4 You will be allowed **10 minutes** to go through the paper before the start of the examination, you may write on this paper but not in the answer book.

5 Begin each answer on a new page.

6 **Please write your examination number on each answer book used. Answer books without examination numbers will not be marked.**

7 All persons writing examinations without payment will risk expulsion from the Institute.

8 If you are caught cheating, you will be automatically disqualified in all subjects seated this semester.

9 DO NOT open this question paper until instructed to do so.

**SECTION A (60 MARKS)**

Answer **ALL** questions from this section

**QUESTION 1**

1. Explain how the following affect the general level of interest rate in the economy:
   * 1. Interest rate abroad. *(2 marks)*
     2. Balance of payment. *(2 marks)*
2. What **two** factors will cause the downward sloping of an interest rate yield curve? *(4 marks)*
3. A farmer purchased 182-day Treasury Bill with a face value of K 5,500,000 at the discount rate of 15.50 %. Calculate the yield on this investment. *(7 marks)*

**(Total 15 marks)**

**QUESTION 2**

In relation to foreign exchange markets, with relevant examples explain the following:

* 1. currency appreciation versus depreciation
  2. the bid-ask spread
  3. nominal versus real exchange rate
  4. Absolute versus relative purchasing power parity
  5. Overvalued and undervalued currency. **(Total 15 marks)**

**QUESTION 3**

XYZ Limited is listed on the Malawi Stock Exchange (MSE). It`s shares are currently trading at K27.50 per share. The company has just published its financial statements where it is mentioned that the declared dividends of K2.75 per share are to be paid in two days’ time. In reaction to this good news, investors have raised their bids to K28.50. It is expected that dividends are to grow steadily at the rate of 6.50% and shareholder’s required rate of return is 16 %.

**Required**

1. With the aid of calculations, comment on whether the raise in the bid price is justified or not. *(6 marks)*
2. In reference to “a” above, give a description of one of the qualities of an attractive market that is applying in this raise of the bid price. *(4 marks)*
3. Explain **two** reasons why companies list on stock exchanges. *(5 marks)*

**(Total 15 marks)**

**QUESTION 4**

1. In a company’s Dividend Policy;
   * 1. Under what **two** circumstances might a company be tempted to pay dividends which are in excess of earnings? *(3 marks)*
     2. What are the **three** dangers associated with the approach (i) above? *(6 marks)*

**Note:** You should ignore tax in answering this question.

1. The directors of ABC Co are currently considering whether to raise finance by means of a bond issue or an issue of preference shares.

**Required:**

Describe **three** reasons why the Directors might choose to issue bonds rather than preference shares to raise the required finance. *(6 marks)*

**(Total 15 marks)**

**SECTION B (40 MARKS)**

Answer **ANY TWO** questions from this section

**QUESTION 5**

An investor`s portfolio as at 1st January 2017 is composed of the following;

|  |  |  |
| --- | --- | --- |
| **SECURITY TYPE** | **NO OF SHARES** | **AMOUNT** |
| Preference shares | 1,000,000 |  |
| Ordinary shares | 1,500,000 |  |
| Put share option | 150,000 |  |
| Forex Future contract |  | USD 500,000 |
| Corporate bond |  | MK 2,000,000 |

**Required:**

Find the **portfolio value** given the following information on the securities:

1. The preference shares are paying a constant dividend of K12.00 per share and its holders require the return of 18%
2. The underlying for the put share option is expected to trade at K75.00 at the end of the year, its holders require a return of 20 % and there is no dividend payout in the year 2017.
3. The ordinary shareholding is expected to pay dividend of K15 per share at the end of the year and is likely to be worthy K218.50 each at that time. All of its holders need a return of 11 %.
4. Banks are currently quoting 550.9612 – 570.2596 as MWK/USD exchange rate. The contract will mature on 30th November 2017.
5. The corporate bond is a zero-coupon bond and will mature in two years’ time. New issues for similar bonds in the market are at 9.50%. **(Total 20 marks)**

**QUESTION 6**

1. Explain clearly by indicating roles played in the flow of funds and financial intermediation in an economic environment. *(14 marks)*

1. What does conflict of preference involve; critically elaborate its importance to the economic world. *(6 marks)*

**(Total 20 marks)**

**QUESTION 7**

1. Explain **four** ways in which preference shares differ from common stock/shares

*(8 marks)*

1. Mention **three** reasons why it is more difficult to value a common stock than to value a bond?  *(6 marks)*
2. Focus PLC paid a dividend this year of K3,000,000. The company expects the dividend to rise by 2% a year in perpetuity. This expectation is shared by the investors in the stock market. The current return expected by investors from shares in the same industry where Focus PLC operates is 11%.

**Required**:

1. Calculate the expected total market value for the shares of Focus PLC? *(3 marks)*
   * 1. Calculate the change in the expected value of the shares of Focus PLC If it is now rumoured in the stock market that interest rates are about to rise and shareholders will want to earn extra 1% on their shares. *(3 marks)*

**(Total 20 marks)**

**QUESTION 8**

Suppose you are a euro-based investor who just sold Microsoft shares that you had bought six months ago. You had invested 10,000 euros to buy Microsoft shares for $120 per share; the exchange rate was $1.15 per euro. You sold the stock for $135 per share and converted the dollar proceeds into euro at the exchange rate of $1.06 per euro.

1. Determine the profit from this investment in euro terms. *(10 marks)*
2. How much of the return is due to the exchange rate movement? *(4 marks)*
3. Grecian Tile Manufacturing of Athens, Georgia borrows $1,500,000 at LIBOR plus a lending margin of 1.25 percent per annum on a six-month rollover basis from a London bank. If six-month LIBOR is 4 ½ percent over the first six-month interval and 5 3/8 percent over the second six-month interval, how much will Grecian Tile pay in interest over the first year of its Eurodollar loan? *(6 marks)*

**(Total 20 marks)**

**END OF EXAMINATION PAPER**