MACHAKOS UNIVERSITY

University Examinations for 2018/2019 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

SECOND YEAR SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF ECONOMICS

BACHELOR OF ECONOMICS & FINANCE

BACHELOR OF ECONOMICS & STATISTICS

EAE 202: FINANCIAL INSTRUMENTS & RISK MANAGEMENT

DATE: 26/9/2019 **TIME: 2.00-4.00 PM**

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) Explain the factors that shift the bond demand curve (10 marks)

b) Explain two main characteristics of ordinary shares (4 marks)

c) Give three areas of distinction between futures and forwards, apart from one being an OTC and the other being conducted under organized exchanges. (6 marks)

d) Distinguish between the following terms;
   i) Coupon and fixed payment bond
   ii) Corporate bond and Commercial paper
   iii) Base rate and receivables
   iv) Investment bank and Stockbroker
   v) Contingent capital instruments and derivative (10 marks)

QUESTION TWO (20 MARKS)

a) If you buy 1000 preferred shares of TPS Serena Ltd, what are you entitled to? (12 marks)

b) Explain the factors that affect the option price. (6 marks)

c) What is an initial public offer (IPO) in relation to issuance of Equities? (2 marks)

QUESTION THREE (20 MARKS)

a) Financial risk is managed by use of financial instruments. Briefly outline these instruments in relation to how they can be used to manage risk (9 marks)

b) What are the specifications of a negative covenant? (5 marks)

c) Discuss the various ways of pricing different types of bonds. (6 marks)

QUESTION FOUR (20 MARKS)

a) Explain 5 various categories of risks faced by financial institutions. (10 marks)

b) There are various types of financial markets operational in the Kenyan Economy. Discuss this statement. (10 marks)

QUESTION FIVE (20 MARKS)

a) There is a 5 % yield on a 1 year bond and a 7% yield on a 30 year bond. Which bond is better) show your workings. (5 marks)

b) Define the yield curve. (3 marks)

c) Briefly explain the risks faced by bondholders (3 marks)

d) Under which circumstances will an embedded derivative be accounted as a derivative? (3 marks)

e) Explain the use of financial instruments (6 marks)