



## DIPLOMA SUMMER 2008 EXAMINATION

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### FUND MANAGEMENT

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<b>DATE OF EXAM</b>	Friday 27 June 2008
<b>3 HOURS</b>	2.00 pm – 5.00 pm
<b>RUBRIC</b>	SECTION A - <i>ALL</i> questions in this section are to be answered SECTION B – <i>ALL</i> parts of the question in this section are to be answered SECTION C – <i>THREE</i> questions in this section is to be answered

**Candidates are reminded that no marks will be awarded for illegible work**

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#### NOTES TO CANDIDATES

1. Please insert your Candidate Number on the Answer Book cover. *Do not insert your name.*
2. Show *all* workings in your Answer Book.
3. Candidates may attempt the sections in any order. Please indicate clearly in your Answer Book which questions you are answering.
4. Please insert in the box provided on the cover of your Answer Book the numbers of the questions you have attempted in the order in which they appear in the Answer Book.
5. You may use the calculator provided or one approved by the Securities & Investment Institute.
6. You must hand your Answer Book to an invigilator before you leave the Examination Hall. *Failure to do so will result in disqualification.*
7. The decision of the panel is final and no correspondence will be entered into concerning the grade awarded.
8. Once submitted, the examination scripts become the property of the Securities & Investment Institute and will not be returned to candidates.

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**PLEASE TURN OVER WHEN INSTRUCTED**

**Answer ALL questions in this section**

- 1 Explain the following terms used with short-term currency swaps;
  - i) Primary currency
  - ii) Secondary currency
  - iii) Synthetic Agreement to Forward Exchange *(3 marks)*
  
- 2 Outline the differences between global and specialised fund management and explain why there is a trend towards specialised fund management. *(3 marks)*
  
- 3 Describe a portable alpha strategy. What would you use as a benchmark for its performance? *(3 marks)*
  
- 4 How can one create a synthetic index fund and what would be its main advantages? *(3 marks)*
  
- 5 A portfolio has total risk of 12% and a systematic risk of 10%. Assess the level of diversification of the portfolio, proportion of unsystematic risk in this portfolio and its correlation with the market. *(3 marks)*
  
- 6 Suppose that you hold 1000 ordinary shares of ABC Plc which are quoted at 110p each. They announce a 1 to 5 rights issue at 95p.
  - a) How many new shares would you hold? Calculate the theoretical ex-rights price. *(1 mark)*
  
  - b) Explain the two forms of price falls associated with rights issues. *(2 marks)*
  
- 7 What are the aims of an investor interested in investing in commodity funds? Outline the main advantages of such an investment. *(3 marks)*

8 a) Explain how correlation coefficient of -1 affects the risk of a two-asset portfolio. *(1 mark)*

b) You are given the following information about two stocks:

	Stock A	Stock B
Expected Return	12%	14%
Standard Deviation	16%	17%

The correlation coefficient between the two stocks is -1. What should be the value of the risk free rate if there are no arbitrage opportunities? *(3 marks)*

9 How would one obtain an alpha of a portfolio? *(3 marks)*

10 Explain the difference between Variable Coupon Gilts and Index-Linked Gilts. *(3 marks)*

**Answer ALL parts of this question**

11 Assume that you are part of a portfolio construction and evaluation team in a large asset management firm. Your boss has asked you to write a report to include the following:

- a) What are fundamental weighted indices and why is their performance similar to a value index? Give an example of a fundamental weighted index. *(5 marks)*
  
- b) What is the difference between Security Market line and Capital Market line? *(6 marks)*
  
- c) What is Fama and French (1993) alpha? *(2 marks)*
  
- d) Explain how you would construct a 'winner' and a 'loser' portfolio if you were following a momentum approach. Make a comment about the expected performance of such portfolios. *(5 marks)*
  
- e) Constant growth Dividend Discount Model is not appropriate for evaluating all equities. Discuss this statement and give an example of a more appropriate model. *(6 marks)*
  
- f) The portfolio you hold is very well diversified and highly correlated with the FTSE 100 index. How would you eliminate systematic risk from the portfolio? *(2 marks)*
  
- g) Explain the difference between strategic and tactical asset allocation. *(4 marks)*

**Answer ANY THREE questions**

**Each question carries 13 marks**

- 12 Explain what 130/30 strategy is and how it compares to market neutral strategy.  
*(13 marks)*
- 13 Private equity firms usually require an exit route in order to realise a return on their investments. Give examples of different exit routes and explain the differences between them.  
*(13 marks)*
- 14 How can one identify an optimal portfolio of risky assets for a risk-averse investor? How would your answer change if there was risk-free borrowing and lending allowed?  
*(13 marks)*
- 15 Value and growth styles are, by definition, mutually exclusive. However, there are investors who search for stocks that exhibit the characteristics of both styles. Discuss this statement.  
*(13 marks)*
- 16 Why does investment theory assume an upward sloping yield curve? If the yield curve is upward sloping and we expect it to steepen following an increase in long term rates and decrease in short term rates, would it be more beneficial to hold a bullet (focused) or a barbell bond portfolio? Explain.  
*(13 marks)*