



DIPLOMA WINTER 2008 EXAMINATION

PRIVATE CLIENT INVESTMENT ADVICE AND MANAGEMENT

DATE OF EXAM	Wednesday 3 December 2008
3 HOURS	10.00am – 1.00 pm
RUBRIC	SECTION A – <i>ALL</i> questions in this section are to be answered SECTION B – <i>ONE</i> question in this section is to be answered SECTION C – <i>ALL</i> parts of the question in this section are to be answered

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

NOTES TO CANDIDATES

1. Please insert your Candidate Number on the cover of your Answer Book. *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 a model 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 Securities & Investment Institute 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 The Companies Act 1985 provides for the appointment of proxies.
- a) i) What is a proxy? *(1 mark)*
 - ii) What are the rights of a proxy? *(1 mark)*
 - b) State FOUR other rights of a registered holder of ordinary shares in a UK listed company. *(2 marks)*
- 2 An inexperienced investor asks you to explain the main differences between hedge funds and traditional fund management. List EIGHT differences. *(4 marks)*
- 3 William bought shares in XYZ plc at various times as follows:
- | | | |
|---------------|------|------------------|
| 4,000 April | 1984 | £3.50 per share |
| 4,000 August | 1986 | £8.21 per share |
| 2,000 January | 2000 | £15.64 per share |
- In September 2008 he sold 5,000 shares for £10.66 each. Calculate the capital gains tax liability, assuming no other gains or losses are realised in the tax year. *(4 marks)*
- 4 Company ABC plc has 6.0% Perpetual Subordinated Loan stock at a market price of £59 per £100 nominal value; and 4.0% net irredeemable convertible preference shares, priced at 27p per £1 nominal value.
- a) Calculate
 - i) the gross flat yield of the loan stock. *(1 mark)*
 - ii) the grossed-up dividend yield of the preference share. *(1 mark)*
 - b) Comment on the difference in gross yields and the value of the conversion rights. *(2 marks)*

- 5 In September 2008 Nick bought 10 contracts in JKL plc 280p December 2008 Call options with an option premium of 24.5p per share; and 10 contracts in JKL plc 270p December 2008 Put options with an option premium of 23.5p per share (ignore expenses). The share price was 274p.
- a) Comment on the intrinsic and time value in each case. *(1 mark)*
 - b) Calculate the overall gain or loss if the share price remained unchanged at 274p on expiry. *(1 mark)*
 - c) Calculate the overall gain or loss if the share price increased to 444p on expiry. *(1 mark)*
 - d) Comment the rationale of the strategy adopted. *(1 mark)*
- 6 Sunita sold a life assurance single premium managed bond for £128,000 in August 2008. It was purchased for £100,000 in July 1998. Withdrawals of £2,000 have been made in each of the ten years. Assuming Sunita's other taxable income in 2008-09 is £32,000, calculate the tax liability on encashment. *(4 marks)*
- 7 a) Define
- i) 'Pump and Dump' *(1 mark)*
 - ii) 'Trash and Cash' *(1 mark)*
- b) Outline TWO other types of behaviour that might be regarded by the FSA in the UK as 'market abuse'. *(2 marks)*
- 8 In respect of settlement in the UK, briefly explain the following terms:
- a) 'Cash against Delivery' (CAD) *(1 mark)*
 - b) 'Cash Memorandum Accounts'(CMA) *(1 mark)*
 - c) 'Cap' *(1 mark)*
 - d) 'Dynamic Headroom' *(1 mark)*

9 Emily invested £5,000 in a 'frontier' emerging market unit trust at the start of the year. After six months the units were valued at £10,000, at which point she invested another £5,000. At the end of the same year the total units purchased were valued at £7,500. Over the complete year the relevant market index fell 10%.

a) Calculate

i) the money weighted rate of return of the portfolio *(1 mark)*

ii) the time weighted rate of return of the portfolio *(1 mark)*

b) Comment on Emily's investment strategy and the performance of the fund manager *(2 marks)*

10 Briefly define the following investment terms:

a) a 'naked bear' *(1 mark)*

b) an 'inverted' yield curve *(1 mark)*

c) a 'backwardation' *(1 mark)*

d) the 'reverse yield gap' *(1 mark)*

(Total 40 marks)

Answer ONE question in this section.

Each question carries 20 marks.

Question 11

An inexperienced investor asks you to review the range of factors affecting the riskiness of a UK quoted ordinary share. Draft a response.

Question 12

Discuss the possible reasons for establishing a discretionary trust and its tax treatment, including transfers into and out of the trust.

Question 13

“By definition, ethical investment must be ‘inefficient’ because it restricts the choice of companies”. Critically analyse this statement in respect of the characteristics of ethical investment and its possible impact on investment performance.

Answer ALL parts of the question in this section

Question 14

David Soule was recently made redundant as an accountant with a major housebuilder. David is aged 52. He received a redundancy payment of £80,000, which is currently held in a building society 30 day notice account. His major financial assets are personal pensions, principally SIPPs, totalling £760,000 at recent valuations. These pensions have been invested largely in higher risk unit trusts. His wife, Moira, also aged 52, took early retirement as a police officer, and receives an index-linked occupational pension of £16,000 per year. She has £50,000 in ISAs. They jointly own a house, currently valued at £400,000, with a £50,000 repayment mortgage.

David is concerned that he might find it difficult to obtain similar full-time employment. He wishes to have a lower risk investment strategy, with a greater emphasis on income. He feels that he and his wife need a minimum pre-tax income of £3,000 per month. He is particularly worried how he would cope with inflation. He would also like to be able to bequeath some assets to his grandchildren, Christopher and Alexander.

In September 2008 David was referred to a stockbroker, who is a strong advocate of equities. The stockbroker, John Jones, said *“Don’t panic! As Rothschild said ‘Buy on cannon, sell on trumpet’! On fundamental grounds, many equities look cheap and should provide protection against inflation. I would suggest a fourfold strategy, largely based on changing the constituents of the SIPP and using income drawdown from the SIPP”*:

1. £300,000 in a FTSE 100 share ETF and £200,000 in a S&P500 ETF
2. £100,000 in a range of smaller companies that match Benjamin Graham’s criteria for ‘deep value’. These criteria include an earnings yield at least twice the AAA bond yield; a dividend yield at least 2/3 of the AAA bond yield; a share price less than 2/3 net current asset value; total debt less than tangible book value. 14 companies, close to these criteria, and with an equity market capitalisation of at least £100m, are recommended: Ladbrokes, Rentokil Initial, Persimmon, Signet Group, William Hill, Bellway, Barratt Developments, Debenhams, Johnston Press, Smiths News, A&J Mucklow, Mountview Estates, Aga Rangemaster, Henry Boot.
3. £240,000 in banks, building societies, and money market funds. This ‘float’ could be used to supplement income and be used as a feeder into:
4. Investment trust regular savings schemes, utilising funds selling at a discount to net asset value.

Initially, David was impressed, but doubts were raised by Sarah Williams, a solicitor and bridge partner. *“Why take the risk”, she says “when you can you can satisfy your needs with index-linked gilts and index-linked National Savings Certificates?”*.

Required:

- a) Discuss the strengths and weaknesses of the strategy recommended by John Jones, the stockbroker. *(20 marks)*

- b) Discuss the advantages and disadvantages of the alternative strategy advocated by Sarah Williams, the solicitor. *(12 marks)*

- c) Analyse the advantages and disadvantages of immediately encashing the personal pensions to purchase an annuity. *(8 marks)*

(Total 40 marks)