



SII MASTERS SAMPLE EXAM QUESTIONS

FINANCIAL MARKETS

DATE OF EXAM

3 HOURS

RUBRIC

SECTION A – answer **FOUR** questions in this section
SECTION B – answer **ALL** parts of the question in this section
SECTION C – answer **ALL** parts of the question in this section

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

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 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

SECTION A**TOTAL 20 MARKS**

There will normally be SIX questions in this section from which candidates should answer FOUR. Each question carries 5 marks.

- 1 Explain what is meant, in classical economic theory, by Say's Law. (5 marks)
- 2 What is meant by Financial Disintermediation in relation to securitisation? (5 marks)
- 3 Explain what is meant by the entry "exceptional items" in a company's Accounts. (5 marks)
- 4 Explain how the efficient frontier can help an investor create an optimal portfolio. (5 marks)
- 5 Outline how a "bill of exchange" operates in the commercial world. (5 marks)
- 6 The UK Government issues a variety of types of "gilts". Briefly describe FIVE types available to an investor. (5 marks)

SECTION B**TOTAL 20 MARKS**

Candidates will be required to answer ALL parts of the question in this section

- 7 Megapix Ltd is struggling to maintain its dominance within the highly competitive Digital Photography market. The planning department has come up with two potential ideas which could secure the company's future. The first idea has Megapix building off-the-shelf processing units for sale to supermarkets for the ever-expanding Express Photo Processing market while the other idea would require development of its recyclable digital cameras which has already passed the prototype stage.

Option one will be called the PhotoLab option while option two will be called the GreenCam option. The management considers five years as the optimal period in which to assess the projects and it has been advised of the following expected cash flows from each option:

	PhotoLab	GreenCam
Initial Outlay (CF₀)	£670,000	£940,000
Year (t)	Cash Inflows (CF_t)	
1	£250,000	£170,000
2	200,000	180,000
3	170,000	200,000
4	150,000	250,000
5	120,000	450,000

The company has an 11 percent required rate of return with an acceptable payback period of 3.5 years and both these alternatives are considered to be equally risky.

- a) What is the Net Present Value (NPV) for each of these two projects and which if any should Megapix choose to invest in? *(7 marks)*
- b) Calculate the IRR for the PhotoLab project. *(5 marks)*
- c) What advice would you give the directors of MegaPix Ltd about using NPV as a long-term investment valuation method? *(8 marks)*

(Total 20 marks)

- 8 The board of directors for Medix Systems Ltd has just announced a £2.50 dividend for next year with a prediction that the dividend will grow at 5% per annum thereafter.
- a) If the required rate of return expected on this type of company is 14%, what is the share price of Medix Systems Ltd? *(4 marks)*
- b) What would be the share price if the directors could only promise the 5% growth in dividends for 3 years after the initial £2.50 dividend payment? Thereafter, from year 5, the dividends will remain constant at the year 4 value (with expected return still 14%). *(6 marks)*
- c) If the share price for Medix Systems was £7.00 last year and over the last 12 months earnings were at £3.50 per share, what was the P/E ratio? What might a low P/E ratio indicate? *(4 marks)*
- d) Bonds issued by Medix System Ltd have been quite popular on the secondary market with a current expected yield of 8% for this basic coupon bond paying semi-annual coupons of £3.00 and a maturity in 5 years. What is the current price of Medix Systems Bonds? *(6 marks)*

(Total 20 marks)

Candidates will be required to answer ALL parts of the question in this section.

- 9 A relatively unsophisticated investor has approached you for advice on various investments available in the UK. She has recently inherited approximately £3m to invest in the UK. She has no problem with any type of investment on religious or moral grounds and is happy to take risks with her investments as long as they are reasonable.

Her investment horizon is at least five years and possibly longer but she does not want to have to worry about individual investments, such as shares, as she will not be able to study detailed information on a regular basis. She has asked you to respond to the following questions:

- a) What are the major differences between the different types of collective schemes available to people in the UK? (15 marks)
- b) If she invested in a collective scheme, how could she be sure that it was performing well? (4 marks)
- c) What are these venture capital trusts that she has heard about? Are they a suitable investment for her? (6 marks)
- d) Although there have been some recent problems in UK property investments, is property investment still a good idea? Discuss the pros and cons of property investment for someone like her. (10 marks)
- e) If she did have religious or moral problems with investing in shares, or interest-paying investments, what alternative could she consider and how would it operate? (5 marks)