EXAMINATIONS

15 September 2000 (am)

Subject 401 — UK Fellowship Investment

Paper One

You must answer this subject only,
you may not attempt another subject in the 400 series.

Time allowed: Three hours

INSTRUCTIONS TO THE CANDIDATE

1. *You have 15 minutes at the start of the examination in which to read the questions. You are strongly encouraged to use this time for reading only but notes may be made. You then have three hours to complete the paper.*

2. *You must not start writing your answers in the booklet until instructed to do so by the supervisor.*

3. *Write your surname in full, the initials of your other names and your Candidate's Number on the front of the answer booklet.*

4. *Mark allocations are shown in brackets.*

5. *Attempt all 9 questions, beginning your answer to each question on a separate sheet.*

AT THE END OF THE EXAMINATION

Hand in BOTH your answer booklet and this question paper.

In addition to this paper you should have available Actuarial Tables and an electronic calculator.

1 (i) You are the bond portfolio manager of a UK pension scheme. All of the members of the scheme are resident in the UK. You are considering investing part of the portfolio in overseas government bonds.

Explain why you might wish to consider investing in overseas bonds. [5]

(ii) You have reduced your choice of overseas bonds to either US Treasuries or German Government Bonds.

List the factors that you would take into account in deciding between US and German bonds. [5]
[Total 10]

2 The marketing manager of a life assurance company, of which you are the investment manager, has written to you suggesting that because of the superior returns of global equities in the 1990's, the managed fund should be over-weight in equities relative to its peers over the next decade.

Explain the issues you will include in your reply commenting on the following items:

(i) The background to the strong global equity returns in the 1990s. [6]

(ii) Why it might be dangerous to extrapolate this trend into the future. [4]
[Total 10]

3 Describe briefly five characteristics that an equity index should have in order to be acceptable as a benchmark for institutional investors. [5]

4 A UK investment consultant and an investment manager are discussing the increasing level of stock specific risk in the FTSE All-Share index.

Explain the issues of stock-specific risk they are likely to consider and suggest ways to reduce it. [10]

5 A United Kingdom pension fund with assets in excess of £2bn of assets under management has asked its property adviser to consider the purchase of a large working farm in the south east of England.

Discuss the issues that the fund might consider in making its decision. [8]

6 The Arcadian equity market has a high exposure to raw materials and mining stocks. You are the investment manager of the well-funded pension scheme of a major Arcadian gold mining company. The fund is heavily invested in the local market.

The trustees of the fund have asked you to protect the fund against the possibility that a persistently low gold price could lead to a collapse of the sponsoring employer and a wind-up of the pension fund.

Discuss possible courses of action that you could take to protect the fund and comment on the overall merit of the trustees' request. [5]

7 You are an actuary who specialises in giving investment advice to wealthy individuals. One of your clients has asked you to advise her on the issues to consider when choosing between two US collective investment vehicles for a portion of her assets. One of the vehicles invests in US equities in the S&P 500, the other provides venture capital to unquoted US companies. Both of the investment vehicles have five year investment performance track records.

Your client has a net worth of over $40 million. She never considers returns without considering the risks taken to achieve those returns.

Explain the points you would make to your client in advising her in choosing between the two investment vehicles, taking into account her awareness of risk-adjusted returns (ignore issues of taxation). [15]

8 You are an advisor to a UK-based pension scheme which invests over £500m in overseas assets.

(i) Explain the choices open to the fund in managing the foreign currency exposure inherent in such investments. [10]

(ii) Discuss the ways in which each of these choices can be implemented. [7]
[Total 17]

9 (i) Describe the methods of trading and the types of derivative contracts traded on the major derivative exchanges in the US and Europe (excluding the UK). [10]

(ii) Describe the following types of dealing instruction and the circumstances in which each instruction might be used by a derivatives trader:

(a) market order
(b) stop order
(c) limit order [6]

Describe the risk faced by a trader in placing a limit order to unwind a long position and suggest a more appropriate order type. [4]
[Total 20]