

EXAMINATIONS

10 September 2001 (pm)

Subject 401 — UK Fellowship Investment

Paper Two

**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 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 You are Chief Investment Officer of an asset management company with £20 billion of funds under management. The product range covers unit trusts, investment trusts, pension funds and the accounts of discretionary private clients and involves both UK and overseas domiciles for the funds. You have 54 staff and they are arranged in teams by asset class and within equities by geographic region except for one, who is the investment strategist and seven, who manage the portfolios and client servicing for your 95 pension fund clients, amounting to £12 billion. The investment trust business amounts to £2 billion (6 clients), the unit trust business to £5 billion (15 funds), open-ended investment companies (one multi-class, 5 classes) are £0.75 billion and private clients are the balance. You do not undertake direct property investment.

- (i) The marketing manager wishes to produce a brochure on the company and would like to illustrate how the investment team functions.

Draw a schematic outlining the appropriate structure including the number of staff in each team. [4]

- (ii) The head of sales, on seeing this schematic, suggests that it might be more appropriate to have the teams structured along product lines.

Discuss the advantages and disadvantages of such a structure. [8]

- (iii) Your strategist suggests that, as an alternative to both, the geographic equity teams should be rearranged into global sector based teams. He believes that fewer staff would be required and that stock selection would be better.

Outline the arguments for and against this view. [9]

- (iv) The distribution of assets for your balanced pension fund is shown below.

UK Equities	50%	Fixed Interest	14%
US Equities	8%	Cash	3%
European Equities	10%	Hedges	2%
Japanese Equities	4%	Other Equities	1%
Asia Pacific Equities	8%		
		Total	100%

Comment on the asset allocation of the balanced pension fund and give full details of what additional information you would require to fully assess this allocation. [10]

- (v) A trustee of one of your segregated pension fund clients has noted that investment outside the UK has not added value to his fund's return either in bonds or equities over the last one-year and ten years. He also notes that the bond portfolio has only conventional gilts whose duration is greater than fifteen years. He suggests that more diversification in the domestic bond portfolio would be more productive.

Explain fully what returns have been achieved from the various markets, what has influenced these returns and comment upon his suggestion. You are asked to make a recommendation giving reasons for it. [15]

- (vi) In light of the volatility in commodity prices, the sales director has suggested that you launch a new open-ended investment company commodity fund and has requested a paper for discussion at the next board meeting.

Discuss the points to be included in this paper giving due consideration to all the issues involved in structuring and running such a fund. [10]

[Total 56]

2 You are the investment manager of a £3 billion global equity portfolio whose base currency is sterling. The investment mandate requires that the fund's currency exposure be fully hedged.

- (i) Compare the use of forward and futures foreign exchange contracts for hedging currency exposures for the equities and index derivatives in your portfolio. [14]

- (ii) Describe the cash flow problems that you could face in using these instruments to hedge underlying exposures. [5]

- (iii) State, with reasons, which of the two instruments the portfolio should use. [3]

[Total 22]

3 A financial adviser, who has a number of clients with regular income needs, has approached you for advice on a new investment trust that is to be launched. It will be a highly geared trust investing 50% of its gross assets in global fixed interest securities and 50% in other investment trusts. The starting yield on the global fixed interest portfolio will be 200 basis points over Libor and the yield on the investment trust portfolio will be not less than 1.5% per annum. It is proposed that £60 million will be raised as equity and a bank loan for £40 million has been agreed with ABC Bank plc. at an interest rate of Libor plus 85 basis points. The fund management fee will be 1% per annum of gross assets. Both the fund management fee and the interest costs will be charged against capital. Administration costs will be £80,000 per annum and will be charged to the revenue account. The fund is to be domiciled in an offshore location for tax purposes and will not be subject to any local taxes. It is expected that all income will be distributed as dividends and paid quarterly. All launch expenses will be paid for by the fund management group that is proposing the launch. The life of the investment trust will be seven years.

- (i) Calculate the likely minimum starting dividend per share that the trust could pay assuming 60 million shares are issued at 100 pence each. [3]

- (ii) Calculate the minimum annual capital return required from the portfolio so that the original capital will be returned after seven years. [2]

- (iii) Draft a report for the adviser on this proposed trust and outline any alternative investments that he might consider. (There are 4 marks available for drafting.) [17]

[Total 22]