

# EXAMINATION

5 September 2005 (am)

## Subject CA1 — Core Applications Concepts

### Paper 1 (Assets)

*Time allowed: Three hours*

#### **INSTRUCTIONS TO THE CANDIDATE**

1. *Enter all the candidate and examination details as requested on the front of your answer booklet.*
2. *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.*
3. *You must not start writing your answers in the booklet until instructed to do so by the supervisor.*
4. *Mark allocations are shown in brackets.*
5. *Attempt all 8 questions, beginning your answer to each question on a separate sheet.*
6. *Candidates should show calculations where this is appropriate.*

#### **AT THE END OF THE EXAMINATION**

*Hand in BOTH your answer booklet, with any additional sheets firmly attached, and this question paper.*

*In addition to this paper you should have available the 2002 edition of the Formulae and Tables and your own electronic calculator.*

- 1** Describe the circumstances under which money market investments may be temporarily unattractive to investors. [4]
- 2** Discuss the features of a corporate bond portfolio that would be taken into account in setting its investment performance benchmark. [6]
- 3** List the items that should be included in a project's written strategy. [7]
- 4** Discuss the steps that should be followed to determine the fair value of a large portfolio of bonds with low liquidity. [8]
- 5**
- (i) State how the expectations theory explains the shape of the yield curve. [2]
  - (ii) Describe three other theories that explain deviations from the expected shape of the yield curve. [6]
  - (iii) Explain why a corporate bond might have a significantly higher yield than a government bond of the same duration. [5]
- [Total 13]
- 6** A charitable trust has a portfolio of assets, mainly invested in conventional government bonds and equities. The only liability of the trust is to pay an annual prize for the best new published book. The prize money has traditionally increased each year in line with inflation.
- (i) Describe two methods of valuing the trust's assets and the implications of each for the valuation of the liabilities. [6]
- The chairman of the trust has expressed an interest in moving assets from conventional bonds into index-linked bonds.
- (ii) State the formula for deriving the expected return on conventional bonds from the return on index-linked bonds. Define any symbols used. [2]
  - (iii) Discuss the circumstances in which it would be appropriate for the trust to choose index-linked bonds over conventional bonds. [8]
- [Total 16]

- 7** A city council is considering building a new tourist and leisure complex which it hopes will appeal to visitors to the city as well as to local residents.
- (i) Discuss the steps necessary to achieve an effective identification of the risks facing the project. [11]
  - (ii) State the major risks associated with this project. [3]
  - (iii) Discuss how each of the risks identified in part (ii) might be mitigated. [6]
- [Total 20]

- 8** A developed country has moved into recession in the last year. In order to boost growth the central bank has lowered short-term interest rates substantially over the last few months.
- (i) Discuss how economic growth, the exchange rate, and inflation in this country might develop over the next two years. [15]
  - (ii) Discuss how these developments are likely to affect the level of equity and commercial property markets. [11]
- [Total 26]

**END OF PAPER**