EXAMINATION

26 April 2010 (pm)

Subject SA6 — Investment Specialist Applications

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 before 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 three 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 from the approved list.

1 The Investment Committee of a small wealth management company are reviewing the asset classes and funds that they recommend to their clients. As the economic adviser to the Committee you have been asked to consider possible scenarios that could occur over the next one to three years.

(i) Discuss the expected performances of the following assets during a period of stagflation.

(a) Domestic Equities
(b) Foreign Equities
(c) Gold
(d) Forestry
(e) Domestic Government Bonds

[20]

There is an election in the home country and many commentators have suggested the incoming government may introduce policies to stimulate the economy and abandon previous controls on inflation.

(ii) Discuss how the performance of the assets in (i) could be expected to change during a period of hyperinflation. [5]

The commercial property market has fallen in recent years but is expected to recover. A property asset manager has recommended a fund that uses derivatives to lock in the expected returns over the next three years. The fund guarantees a return of 7.5% plus/minus the manager’s performance relative to an agreed Property Index.

(iii) Explain how this structure works in practice. [6]

(iv) State the advantages and disadvantages of investing in the fund. [5]

Many clients have built up significant cash holdings awaiting investment and have expressed disappointment at the low return they are achieving from the pooled current account the wealth management company operates for its clients. The research team have identified a new 10 day notice account that offers a much better return. The deposit taker is a subsidiary of a large mutual insurance company that only offers on-line and telephone banking.

(v) Outline the factors that the Investment Committee should review prior to switching cash to the new account. [12]

[Total 48]

2 Following a reduction in unsecured bank lending to the corporate sector, due to a shortage of capital within the banking sector, an enterprising fund manager believes that there is an opportunity to create a pooled fund for institutional investors that carries out this type of lending. In the launch prospectus, the manager has highlighted the following details for target loans:

Loan portfolio

Target loan size	£1m to £50m
Target proportion of unsecured loans	70%
Lending rates	3m LIBOR + 250bps to 1000bps
Loan tenors	Maximum 5 years
Permitted investments	Direct loans, syndicated loans from banks, sub 12 month cash instruments. New and existing loans permitted.
Maximum exposure to a single name	5% of fund for investment-grade issuers or secured loans, 2.5% otherwise.

Fund details

Management fee	75bps + 15% of returns in excess of LIBOR + 300bps (net of fees), high water mark applies
Total expense ratio (before performance fee)	100bps
Other terms	6 months notice required, minimum lock-up period of 2 years (at manager's discretion)

You are an analyst within an investment advisory firm, and have been asked to research this new fund.

(i) Explain why your clients might be interested in investing in this particular fund. [3]

(ii) Discuss the potential risk factors for the investors in this fund. [20]

(iii) Describe three alternative ways in which a £10bn pension fund could obtain exposure to the above or similar loan assets. [3]

(iv) List the advantages and disadvantages of each approach in (iii). [9]

[Total 35]

3 (i) Discuss the challenges facing regulators of financial markets. [10]

(ii) Explain what a minimum reserve requirement is and how this differs from a risk-based capital requirement. [3]

(iii) Give reasons why a regulator may prefer a risk-based capital requirement to a non risk-based capital measure with a higher level of coverage. [4]

[Total 17]

END OF PAPER