

This is a mock examination showing the format of the AcF 304 Jun 2024 examination which has a small number of format changes compared to previous years examinations. Note the change in Section C, particularly, which is Commercial Awareness focussed this year. Note, also, the slight changes to mark allocation per section.

PART II FINAL YEAR

ACCOUNTING AND FINANCE

AC.F 304 FINANCIAL MARKETS

DURATION: **2 hours + 15 minutes reading time**

This examination paper consists of **four** sections.

All Sections (A, B, C and D) are compulsory.

Ensure that the start and end of each question is clearly identifiable.

The use of standard calculators with scientific, and standard arithmetic and statistical functions, is permitted.

SECTION A (28 marks)

- Section A consists of 28 MCQ (Multiple Choice Questions) worth 1 mark each.
- Answer all questions. Choose only one answer for each question.
- Two or more answers provided, illegible answers, are considered as incorrect answers.
- There are no marks deducted for an incorrect answer.

1) The presence of _____ in financial markets leads to adverse selection and moral hazard problems that interfere with the efficient functioning of financial markets

- A) Non-collateralized risk
- B) Free-riding
- C) Asymmetric information
- D) Costly state verification

2) If today is Monday 1st February, and I enter into a 2-month forward Foreign Exchange transaction. The value date will be

- A) April 3rd
- B) April 1st
- C) April 2nd
- D) March 31st

3) Trading bonds via an ECN (Electronic Communications Network) is most suitable for

- A) Corporate Bonds
- B) Government Bonds
- C) Bonds approaching maturity
- D) Derivatives

4) Investment Banks are quoting the following GBP/USD rates.

Bank A GBP/USD 1.1990 BID - 1.2010 OFFER

Bank B GBP/USD 1.2012 BID - 1.2022 OFFER

Bank C GBP/USD 1.1995 BID - 1.2015 OFFER

You, the Client, wish to BUY GBP and SELL USD.

What is the best price available to you?

- A) 1.1990
- B) 1.2010
- C) 1.2022
- D) 1.1995

5) What term is NOT associated with Mortgage-Backed Securities

- A) CMO
- B) MBS
- C) SPV
- D) CDS

6) A Federal Reserve open market purchase of bonds leads to

- A) An increase in the banking system's balance sheet and an increase in the Federal Reserve's balance sheet
- B) No change in the banking system's balance sheet and no change in the Federal Reserve's balance sheet
- C) An increase in the banking system's balance sheet and no change in the Federal Reserve's balance sheet
- D) No change in the banking system's balance sheet and an increase in the Federal Reserve's balance sheet

7) An FX Swap is when

- A) One currency is permanently swapped for another
- B) Two trades take place with the second being the reverse of the first
- C) One currency is swapped with the seller having the right to swap it back in the future
- D) Two trades take place with the second one within 3 months of the first

8) What would be the annualised discount rate % if a Treasury Bill was purchased for \$9,650 maturing in 182 days for \$10,000?

- A) Discount Rate 7.19%
- B) Discount Rate 7.02%
- C) Discount Rate 7.17%
- D) Discount Rate 6.92%

9) Who are the big winners from MiFID 2?

- A) Sell Side firms
- B) Technology providers and compliance firms
- C) Buy Side firms
- D) Regulators

10) All the statements about LIBOR and the FED FUNDS RATE are true EXCEPT

- A) When banks borrow via Fed Funds they can only borrow and lend via their Reserve Account at the Federal Reserve
- B) The Fed Funds Rate has one rate whilst there are 35 different LIBOR rates
- C) The Fed Funds Rate is the equilibrium rate based on transactions between bank buyers and sellers
- D) LIBOR is the equilibrium rate based on transactions between bank buyers and sellers

11) For a company's securities, all of the same maturity, what would be the logical interest rate payable to investors on the company's Subordinated debt if the company's Senior Unsecured debt paid an interest rate of 4% and the company's Preferred Stock paid a 6% interest rate?

- A) 3%
- B) 5%
- C) 7%
- D) 8%

12) The Fed Funds Rate will never go above the Fed 'target rate' because

- A) Additional funding is available to banks at the Discount Window Primary Credit Rate set at the upper end of the Fed's target rate for Fed Funds
- B) Additional funding is available to banks at the Discount Window Secondary Credit Rate set at the upper end of the Fed's target rate for Fed Funds
- C) Additional funding is available to banks at the Discount Window Seasonal Rate set at the upper end of the Fed's target rate for Fed Funds
- D) The Fed Funds Rate does often go above the Fed 'target rate'

13) As an Investment Bank Foreign Exchange trader, you are 'long' GBP 100,000 and wish to sell this position.

Three banks are making the same price in GBP/USD 1.3410 – 1.3420. What is a logical price for you to make to clear your trading position?

- A) GBP/USD 1.3410 – 1.3420
- B) GBP/USD 1.3415 – 1.3425
- C) GBP/USD 1.3415 – 1.3420
- D) GBP/USD 1.3405 – 1.3415

14) All the following are TRUE of the MiFID 2 regulation EXCEPT

- A) It may make banks more reluctant to trade securities
- B) It has led to an increase in Investment Bank research hiring
- C) It has led to increased research revenue for Investment Banks
- D) It ensures Buy Side 'Best Execution'

15) A UK firm knows it is going to receive \$400,000 in September. The current spot and future exchange rates are

| Exchange Rates GBP/USD | |
|------------------------|--------|
| Period | Rate |
| Spot | 1.3550 |
| March | 1.3680 |
| June | 1.3790 |
| September | 1.3830 |
| December | 1.3980 |

The UK firm decides to fully hedge the position. When September arrives, the actual exchange rate is GBP/USD rate is 1.3740. How much did the UK firm gain or lose by this strategy?

- A) \$1,894.50 gain
- B) £1,894.50 gain
- C) \$1,894.50 loss
- D) £1,894.50 loss

16) According to the liquidity premium theory of the term structure

- A) the interest rate on long-term bonds will equal an average of short-term interest rates that people expect to occur over the life of the long-term bonds plus a liquidity premium
- B) buyers of bonds may prefer bonds of one maturity over another, yet interest rates on bonds of different maturities move together over time
- C) even with a positive liquidity premium, if future short-term interest rates are expected to fall significantly, then the yield curve will be downward-sloping
- D) all of the above

17) Basle 3

- A) Makes security prices more visible
- B) Makes it easier for Investment Banks to take trading positions
- C) Makes it more restrictive for Investment Banks to take trading positions
- D) Means banks have to charge the Buy Side for research.

18) (I) The Federal Reserve has a dual mandate focused on price stability and full employment
 (II) The European Central Bank has a dual mandate focused on price stability and full employment
 (III) The 'Beige Book' is a summary of current economic conditions across the 12 Federal Reserve Districts

- A) (I) is true, (II) is false, (III) is false
- B) (I) is false, (II) is true, (III) is true
- C) (I) is true, (II) is false, (III) is true
- D) (I) is false, (II) is false, (III) is true

19) In 2020 the price of US oil, for immediate delivery, reached an all-time low of minus \$40 per barrel because

- A) The minus \$40 price was a computer error and the price should have been plus \$40
- B) Demand for oil fell by 20%
- C) OPEC & Russia agreed to cut production
- D) There was practically no US storage capability with production still strong

20) What would be the annualised discount rate % if a Treasury Bill was purchased for \$9,650 maturing in 182 days for \$10,000?

- A) Discount Rate 7.19%
- B) Discount Rate 7.02%
- C) Discount Rate 7.17%
- D) Discount Rate 6.92%

21) The relationship between the US Prime Rate and the return on Commercial Paper can be described best by which of the following statements?

- A) The Prime Rate has no relationship with the return on Commercial Paper
- B) The Prime Rate is usually a few percentage points higher than the return on Commercial Paper, and both move up/down in a similar fashion
- C) The Prime Rate and the return on Commercial Paper are usually about the same interest rate
- D) Because Commercial Paper is riskier, returns on Commercial Paper always exceed the Prime Rate

22) Which of the following can be described as involving direct finance?

- A) A corporation's stock is traded in the secondary market
- B) A pension fund manager buys commercial paper in the secondary market
- C) An insurance company buys shares of common stock in the over-the-counter markets
- D) None of the above

23) According to the Gordon growth model, what is an investor's valuation of a stock whose current dividend is \$1.00 per year if dividends are expected to grow at a constant rate of 10 percent over a long period of time and the investor's required return is 11 percent?

- A) \$110
- B) \$100
- C) \$11
- D) \$10

24) The US Dollar is the base currency for FX currency pair quotation purposes except for

- A) CAN \$, AUD, NZD
- B) EUR, GBP, AUD, NZD
- C) EUR, CAN \$, AUD, NZD
- D) EUR, GBP, CAN \$

25) Stage Three of a financial crisis in an advanced economy features

- A) A general increase in inflation
- B) Debt deflation
- C) An asset price boom
- D) A full-fledged financial crisis

26) If, as a financial professional, I believe US interest rates are going to gradually fall over the next two weeks, which investment strategy would it make sense to engage in?

- A) Sell short-maturity US Government Bonds
- B) Buy US Dollars
- C) Engage in a 14-day REPO and fund myself on an overnight basis
- D) Engage in a 14-day REVERSE REPO and fund myself on an overnight basis

27) Bond Issue Restrictive Covenants are related to

- A) Adverse Selection
- B) Moral Hazard
- C) Direct Finance
- D) Indirect Finance

28) Which yield curve theory best explains a 'humped' shaped yield curve?

- A) Pure Expectations Theory
- B) Liquidity Preference Theory
- C) Market Segmentation Theory
- D) None of the above

Total 28 marks

SECTION B (36 MARKS)

SECTION B CONSISTS OF 8 QUESTIONS (29 – 36)

ANSWER 6 OUT OF THE 8 QUESTIONS

6 MARKS PER QUESTION

29) Why has there been a trend towards Passive versus Active investment over the last several years? How do Active managers argue they are still relevant and how are they strategically responding?

30) What are the core features of a Credit Default Swap? Describe the motive of the Protection Buyer and Protection Seller.

31) Explain why Floating Rate Note (FRN) price volatility is typically significantly less than for bonds with a fixed coupon rate.

32) How did the structure of US Mortgage Bonds instigate the 2008 Financial Crisis?

33) How does a flat yield curve represent a different interest outlook under the Expectations Theory versus the Liquidity Preference Theory?

34) Explain how the problem of asymmetric information has led to the crucial role of financial intermediaries within the financial system.

35) What is a REPO? How might a Central Bank use it as a tool of monetary policy?

36) Why would 'haircuts' on collateral increase sharply during a financial crisis?

Total 36 marks

SECTION C (18 MARKS)

SECTION C CONSISTS OF 4 COMMERCIAL AWARENESS QUESTIONS 37 – 40

ANSWER 3 OUT OF THE 4 QUESTIONS

SIX MARKS FOR EACH QUESTION

In a paragraph or so answer 3 out of the 4 questions below.

37) What is meant by the ‘Yen Carry Trade’? Is it a viable investment option in financial markets today?

38) Commercial Awareness second question.

39) Commercial Awareness third question.

40) Commercial Awareness fourth question.

Total 18 marks

SECTION D (18 MARKS)

SECTION D CONSISTS OF 4 QUESTIONS 41 – 44

ANSWER 3 OUT OF THE 4 QUESTIONS

SIX MARKS FOR EACH QUESTION

*In a couple of paragraphs or so explain **3 out of the 4** concepts and questions below.*

41) Exchange Traded Funds and their popularity with investors over the last several years

42) How should gold theoretically behave in a financial crisis and why did gold struggle to perform well in 2022?

43) MiFID2 and its Buy/Sell side implications

44) Underpricing & 'Money left on the table' (*Include numerical examples*)

Total 18 marks

END OF EXAM