UNIVERSITY OF FORT HARE

DEPARTMENT OF ECONOMICS

EAST LONDON CAMPUS

ECF 527E

NOVEMBER EXAMINATION 2019

Time: 3 Hours

Subject: Debt Markets **Marks: 100**

This paper consists of 4 pages including the cover page

Internal Examiners

Dr I. Akpan

External Examiner

Prof A Maredza

Instructions

1. There are six (6) questions in all
2. Answer any four (4) questions of your choice.
3. All questions carry equal marks

Question 1 ***25marks***

Participants in debt markets utilize the market to satisfy different needs.

(a) Identify **five** market participants and discuss their interest in debt markets. 15marks

(b) Do rating agencies add any value to debt markets? Provide reasons for your answer. 10marks

Question 2 ***25marks***

Bond managers have a choice between active or passive portfolio management styles. Discuss the **strategies** and **problems** associated with each of the management styles. Do you believe that there is any merit in active portfolio management style? Substantiate your answer.

Question 3 ***25marks***

Discuss the theories of the term structure of interest rates. Which of these theories best explain investment behaviour of pension fund and insurance companies? Provide reasons.

Question 4 ***25marks***

If yield is not properly understood, investors run the risk of incorrectly estimating yield on their investments.

(a) Identify and explain **different types of yield** in bond markets **and** indicate which yield is **most valu**able in estimating investors' return and **why.** 13marks

(b) An investor is considering investment in bonds. Three bonds are available for consideration:

- A five (5) year zero coupon government bond with a nominal value of R2 000 000 and yield to maturity of 12%.

- A five (5) year R2 000 000 government bond with coupon rate of 9% (compounded semi-annually) and yield to maturity of 11%.

- A R2 000 000 **perpetual bond** with coupon rate of 9% and YTM of 10%.

Calculate the price of each bond and advise the investor on which bond to purchase and why? 12marks

Question 5 ***25marks***

(a) An investor approached Billion Bank with an investment plan. The bank promised to pay R2 000 000 to the investor in **two** year's time based on interest rate of 10%.

Calculate how much an investor should invest in the fixed deposit now if interest is compounded

(i) Weekly 4marks

(ii) Monthly 4marks

(iii) Quarterly 4marks

(iv) Semi-annually 4marks

(v) Annually 3marks

(b) Explain the importance of time value of money in money market transactions 6marks

Question 6 ***25marks***

(a) Distinguish between a cum interest bond and ex interest bond. 2marks

(b) Explain the relationship between yield to maturity of a bond, term to maturity of a bond and bond price 3marks

(c) ABC Ltd issued a corporate bond with a par value of R1 000 000. The bond's coupon rate is 11% with semi annual coupon payments, maturity is in two (2) years and the yield to maturity is 11%.

(i) Calculate the price of the bond.. 4marks

(ii) If maturity of the bond is three (3) years, holding all other factors in (c) above constant, calculate the price of the bond 4marks

(iii) If the yield to maturity is 9%, holding all other factors in (c) above constant, calculate the price of the bond 4marks

(iv) Comment on your findings in (i) – (iii) above. 4marks

(v) If interest rates in the market has risen to 12% since ABC Ltd issued its bonds two years ago, **explain** the effect this would have on ABC Ltd's bond (no calculations needed). 4marks

……………….*Good luck*