**INTERNAL SUMMATIVE ASSESSMENT - Model Answers**

**105026: Occupational Certificate: Financial Adviser**

**Module 6: Investments Advice (ID 105021)**

**Learning units: 1 – 7**

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| ***NOTE TO Assessor***  *The model answers given are a guideline and not as conclusive, except for those with calculations. Use own discretion based on your expertise and knowledge of the subject area.* |

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| **SECTION A: Multiple choice questions**  1. Diversification reduces [1]  A. Income  B. Capital Gains  C. Taxes  D. Risk  2. The following are all key macroeconomic variables, **EXCEPT**… [1]  A. The unemployment rate  B. The inflation rate  C. Gross domestic product (GDP)  D. Income distribution  E. National Legislation  3. A record of advice must reflect the basis on which advice is given to a client as part of the requirements of the Financial Advisory and Intermediary Services Act (FAIS) and its General Code of Conduct. Which of the options below is **INCORRECT**? [1]  A. A record of advice must include a brief summary of the information and material on which the advice was based, as well as the financial product(s) that were considered.  B. All records must be kept for a period of five years after termination, to the knowledge of the financial planner, of the product concerned.  C. The financial product(s) recommended with an explanation of why the selected product(s) will most likely satisfy the client’s identified needs and objectives.  D. A copy of the record of advice must be given to the client only if the client requests it.  4. If financial markets are efficient, that suggests that  A. Investors cannot earn superior returns  B. Investors cannot expect to outperform the market consistently  C. Security prices are random  D. Bearing additional risk will not increase return.  5. Possible investment objectives may include:  i) capacity to meet financial emergencies  ii) preservation of capital  iii) Desire to finance retirement.  A. i and ii  B. i and iii  C. ii and iii  D. All of the above. |
| **Section B: True/False questions**  6. Capital gains are the sole source of the return on an investment. F  7. Albert Lead, a financial planner, has had his professional membership status suspended while a complaint that was brought against him for unprofessional conduct is being investigated. According to the Code of Ethics and Professional Responsibility of the Financial Planning Institute of Southern Africa, unless Albert is debarred, it is not necessary to inform his client base. F  8. The Collective Investment Schemes Control Act, 45 of 2002, controls and regulates the establishment of collective investment schemes. Collective investment schemes (“CIS”) are a way of investing money in order to benefit from the advantages of investing as part of a group. T  9. It is often said (and has been proven by research) that the correct combination of asset classes will give an investor optimal returns. T  10. The investor should specify the objectives of investing. T |
| **Section C: Short and long-answer questions**  **Question 11 (6 marks)**  Which three factors should be taken into account when establishing the appropriate asset class allocation for your client? Briefly motivate each factor. (6)  *- Financial goal – financial goals range from saving for retirement, buying to hold or to fund a certain lifestyle or project.*  *- Risk tolerance – this relates to the level of risk that the investor can take. Some investors are conservative whereas others are aggressive.*  *- Investment time horizon – there are certain assets that are suited for short-term investing e.g. money markets, while others are suited for long-term investment horizon such as equity.*  *- Taxation and costs - taxation is an issue that needs to be taken into account as this affects the net yield. Similarly, costs involved in the investment would have to be taken into account in calculating the net yield.* |
| **Question 12 (5 marks)**  Describe the negative consequences that may arise should clients and members of the public fail to plan their finances adequately. [5]   * *Clients may not have sufficient capital and income on which to retire. They would have to continue working past retirement age or they may become a burden to their families.* * *The state may become overburdened, as too many people will depend on the state system at retirement.* * *Clients will not be in a position to achieve their lifestyle goals and dreams.* * *Levels of debt may rise to unmanageable levels.* * *The health of clients may be affected as they become more and more stressed as their finances are completely out of control.* |
| **Question 13 (10 marks)**  The following is an excerpt from your financial needs analysis.   |  |  | | --- | --- | | Name and surname | Misumzi Scott | | Date of birth | 1979-12-22 | | Marital status | Married in community of property | | Risk profile | Conservative – according to the risk profile questionnaire used | | Gross salary p.m. | R40 000 | | Client instruction | He needs assistance in building an investment portfolio to ensure that he can retire comfortably at age 65 |   You have calculated that Mr. Scott will need to save an amount of R8 000 p.m. with a return of 10% on his investments to meet his objective.  Construct an investment portfolio for Mr. Scott, based on his risk profile as identified above. In your answer you are expected to:  - indicate and motivate the risk profile you are using,  - indicate which asset classes you will use,  - indicate the portion of his portfolio that each asset class will represent, and  - Briefly evaluate each asset class in terms of the purpose thereof in the portfolio.  Please use the following format:   |  |  |  | | --- | --- | --- | | Asset class | % exposure | Evaluation | | Cash | 30 (Range 25 – 35%) | *Cash and cash equivalents - such as savings deposits, certificates of deposit, treasury bills, money market deposit accounts, and money market funds - are the safest investments, but offer the lowest return of the other asset categories. The chances of losing money on an investment in this asset category are generally extremely low. The cash allocation in the portfolio would meet the risk profile of a conservative investor like Scott.* | | Bonds | 40 (Range 30 – 45%) | *Bonds are generally less volatile than stocks but offer more modest returns. As a result, an investor approaching a financial goal might increase his or her bond holdings relative to his or her stock holdings because the reduced risk of holding more bonds would be attractive to the investor despite their lower potential for growth. This allocation would suit Scott.* | | Equity | 25 (Range 15 – 25%) | *Equities have historically had the greatest risk and highest returns among the other asset categories. As an asset category, equities are a portfolio’s “heavy hitter,” offering the greatest potential for growth. Stocks hit home runs, but also strike out. The volatility of stocks makes them a very risky investment in the short term. Large company stocks as a group, for example, have lost money on average about one out of every three years. For a conservative investor like Scott, a low exposure to equities is ideal.* | | Offshore | 5 (Range 3 – 10%) | *Investments in offshore equities are sometimes considered riskier compared to local equities and fixed income.*  *This is for investors who want to invest in economies, geographic regions and a broader selection of companies, and in doing so increase your potential to earn returns under different conditions. Developed economies often have much lower interest rates and therefore your investment may grow much.* |   ***Note to Assessor:*** *The learner may provide any other form of conservative asset allocation as long as there will be less exposure in equity and offshore stocks. A conservative investor will go for low risk investments.*  Assume that Mr. Scott’s investment portfolio can be constructed, based solely on his risk profile. Briefly mention the effect that this will have on his long-term investment goal. [2]  *Basing investment decisions on risk profile alone is not sufficient. Sometimes the risk profile may change over time. The other factors to include involves investment goals and financial needs and the investment horizon.* |
| **Question 14 (7 marks)**  Mrs. Nolundi has approached you for advice as she wishes to invest a substantial amount of money in the purchase of the shares of a company listed on the stock exchange. Explain to her what it will mean to own shares and how she should go about deciding which company’s shares to buy. [7]  *Holders of ordinary shares are, in effect, the owners of the business. The investor who holds the largest number of shares, particularly if this should be more than 50% of the total number issued, is the de facto controller of the company.*  *Ordinary shares are part of the capital of the company. The holders of the shares have proprietary rights in the company and residual profits (and capital on winding-up) of the company belong to them after all prior charges and dividends to preference shareholders have been met.*  *Investors in ordinary shares of a company suffer most in the event of a decline in the fortunes of the company, but they also stand to profit most by improving fortunes of the company.*  *Before choosing to invest in the ordinary shares of an individual company it is necessary to assess the future prospects of the concern. Company reports, chairman’s statements and writings in the press should be scrutinised before a decision is made.*  *the most important points that must be taken into account when considering an investment in a particular company’s ordinary shares:*  *• the nature of the company’s activities, the amount of competition and scope for expansion;*  *• the quality of the board of directors and management;*  *• the capital structure - amounts of ordinary, preference and debenture stocks and the rights and powers of each;*  *• the amount of surplus earnings over the amount required to service the contemplated investment;*  *• At least a five-year comparison of the trading results and balance sheet items and of the financial records (including debenture, interest and dividend records) of the company.* |
| **Question 15 (8 marks)**  Describe the benefits of following the 6-step financial planning process [2]  *The 6‐step financial planning process together with the practice standards defines the standard of performance expected from financial planners by:*  *Establishing the level of practice expected of a financial planning professional engaged in the delivery of financial planning to a client;*   * *Establishing norms of professional practice and allowing for the consistent* * *delivery of financial planning by financial planning professionals;* * *Clarifying the respective roles and responsibilities of financial planning* * *professionals and their clients in financial planning engagements; and* * *Enhancing the value of the financial planning process.*   List the 6 steps [6]  *Step1: Establish and define relationship*  *Step 2: Gathering client data ‐ factual and personal*  *Step 3: Analyse information*  *Step 4: Prepare and present recommendations and solutions*  *Step 5: Implementation*  *Step 6: Reviewing and monitoring.* |
| **Question 16 (7 marks)**  a) Besides meeting the FIC Act requirements, list examples of how a financial adviser can contribute towards combating money laundering. [4]  *Financial advisers can assist with the prevention of money laundering by:*   * *Being aware of situations that do not feel right.* * *Acting on any suspicions or feelings by reporting them to a more senior person (even if the suspicions or feelings are unfounded rather report them and have them checked out).* * *Paying attention and giving effect to all the compliance requirements.* * *Keeping up to date by attending regular training.*   b) List any 3 money laundering indicators that financial advisers must be wary of. [3]  *The FIC identified the following money laundering indicators in the scam:*   * *Use of false identities to open and operate accounts.* * *The prevalence of ‘trade as’ accounts to commit fraud or other financial crimes.* * *Investments promising unrealistically high returns over a short period of time.* * *Numerous cash deposits not followed by the agreed investment.* * *The purchase of high‐value assets and lifestyle expenses.* |
| **Question 17 (6 marks)**  Siphamandla needs to borrow R500 000 in order to assist him in starting up his own business. He has been offered the following credit terms all of which are only repayable after one year:  i) 8.5% compounded monthly  ii) 9.1% compounded quarterly  iii) 9.25 compounded bi-annually  You are required to advise Siphamandla which of the three situations will be the cheapest form of credit. Show calculations.  *To determine the cheapest form of credit, we need to calculate the future value at the end of the year using the following formula:*  *Future value = PV (1 + r)n*  *Where PV is the present value, r is the effective interest rate and n is the number of periods*  *i)*  *FV = 500 000(1 + (8.5%/12))12*  *= R544 195.45*  *ii)*  *FV = 500 000(1 + (9.1%/4))4*  *= R547 076.37*  *iii)*  *FV = 500 000(1 + (9.25%/2))2*  *= R* *547 319.53)*  *Therefore the 8.5% compounded bi‐annually will be the cheapest form of credit.* |
| **Question 18 (5 marks)**  Preform some time-value of money calculations in the situations below.  a) Find the future value of R10 000 invested at a simple interest rate of 10% per annum for 3 years. [1]  *Future value = 10000 + 10 000 x 10% x 3*  *= R13 000*  b) Find the amount that should be invested at a simple interest rate of 9% per annum which will have to have a future value of R5 460 after a term of 5 years. [2]  *Present value = 5 460\_\_\_\_*  *(1 + 0.09X5)*  *= R3 765.52)*  c) How many years will it take R20 000 to grow to R26 000 at a simple interest rate of 10% per annum. [2]  *FV = PV x [1 + n(i)]*  *26 000 = 20 000 x [1 + n(0.10)]*  *= 20 000 x 2000n*  *20 000 x 2000n = 13 000*  *n = (26 000 - 20 000) ÷ 2000*  *= 3*  *It takes 3 years for R20 000 to grow to R26 000* |
| **Question 19 (12 marks)**  Perform the following compound interest calculations. In all cases, show calculations:  a) Mrs Du Plessis invests a lump sum of R100 000 for 2 years. The applicable interest rate is 10% compounded half yearly. What will his investment be worth after 2 years? [3]  *FV = 100 000(1+0.1/2)4*  *= R121 550.63*  b) Thulani, your client wants to invest a lump sum of R250 000 for a period of 4 years. He will earn interest of 11% per annum, compounded annually. He wants to know what the investment will be worth in 4 years’ time. [3]  *FV = 250 000(1 + 0.11)4*  *= R379 517.60*  c) Samantha has bought a flat for R850 000. She intends applying for a 90% bond and wants to know what her monthly payments will be if the repayment period is 15 years and the current bond interest rate is 11.5% per annum. [4]  *90% bond = R765 000*  *FV = 765 000 + 765 000 x 11.5% x 15*  *= 2 084 625*  *Monthly repayment =2 084 625/180*  *= R11 581.25*  d) Mr Nelson wishes to buy a flat for his son when he goes to university 7 years from now. Currently a flat would sell for R650 000. He wants to know how much he would need to buy a similar flat in 7 years’ time assuming a 5% interest rate per annum. [2]    *650 000X(1.05)5=914,615.27* |
| **Question 20 (8 marks)**  Analyse the following graphs.  Fund A    Fund B    a) Compare and contrast the two graphs [4]  *The amount invested is the same, R100, 000.*  *It does seem that fund A is a high risk investment as can be seen from the high volatility in the fluctuations. This seems suited to aggressive investors. Fund A ends the highest return at the end of the investment period.*  *Fund B on the other had is smoother. The rise is quite gradual and it is less volatile and hence high risk. Fund B would be suited for conservative investors. It earns a lower return as compared to fund A.*  b) Explain why the volatile fund (A) might pose a risk for one investor and not for another. [4]  *There is high volatility during a period where an investor is withdrawing income from the fund which may lead to capital loss, whereas for a younger investor with a longer time horizon the downturn will allow an investor to purchase more units.* |
| **Question 21 (6 marks)**  Monique has held a 2-hectare piece of vacant land in Brits for a considerable length of time. A developer approached him with an offer to purchase half of the property for R800 000. An estate agent has valued the entire property at R2 000 000. The market value of the property on 1 October 2001 (when capital gains tax was introduced) was R1 400 000 and Monique has elected to use the market value to determine base cost on valuation date.  Determine the capital gain if Monique sells half of the property for R800 000.  *Part disposal:*  *Allowable expenditure of the entire asset x MV of the asset disposal /MV of the entire asset*  *Base cost of entire asset 1 400 000*  *Market value of part disposal 800 000*  *Market value of entire asset 2 000 000*  *BC of part disposal = R1 400 000 x (R800 000 / R2 000 000) = R560 000*  *Monique would realise a capital gain of R240 000 (R800 000 – R560 000) if he were to dispose of portion of the vacant land to the developer.* |
| **Question 22 (5 marks)**  Over the last three years, Anton Swinton has allowed his sister, Suzie Green, who works as a credit controller for a large construction company, to make an unusually large number of deposits into his account. Anton then transfers the money to Suzie’s account or he makes out cheques in her name. According to Suzie, who lives an extravagant lifestyle, she is extremely busy running two small businesses in her spare time and looking after her large investment portfolio.  With reference to the abovementioned facts, discuss whether Anton can be considered to have ‘knowledge’ relating to the proceeds of unlawful activities as required by the Prevention of Organised Crime Act 121 of 1998. [4]  *Anton as the owner of the bank account had a duty to know the source of funds that were coming into his account. In equal measure, the bank with which Anton holds an account should have raised red flags seeing that as an accountable institution, one of the indicators of money laundering is an unusually high number of transactions especially into a personal bank account.*  *That said, Anton is construed to have constructive knowledge of what was happening in his account and is therefore liable.* |
| **Question 23 (5 marks)**  Dimpho had been saving for years. Her dream was to buy her own house. After receiving a large amount of money as a long service bonus from her company, she makes an appointment to see her financial planner, Ben Ngubane, at his offices. Ben is an employee at a well-known bank. He has been Dimpho’s financial planner for the past ten years and all her investments have been done through the bank. However, following this latest appointment, instead of investing the money in the range of products he was authorised to invest in through the bank, Ben invested the money with a high-risk company that had nothing to do with the bank. As a result, Dimpho lost her investment, which she believed had been invested with the bank all along.  Briefly discuss whether the bank, as Ben’s employer, can be found liable for the loss Dimpho suffered.  *When Dimpho came, her understanding was that Ben was investing her funds in the Bank with which he was working. Ben does not seem to have indicated that to Dimpho that her funds were going to be invested in a different financial service provider.*  *Given this, because Ben misrepresented to Dimpho during the course of his work, the bank as the employer should be vicariously liable. If the Bank was not employing Ben, Dimpho would have not lost her funds. It follows that the Bank should repay Dimpho of her money and deal with Ben separately through both criminal and normal employment disciplinary procedures.* |
| **Question 24 (6 marks)**  a) Define the term collective investment scheme [2]  *A collective investments are investments that enables an investor to pool their money with other investors who have similar investment objectives. Experienced investment managers invest this pool of money in different assets in financial markets.*  b) Discuss any four advantages of collective investment schemes as a form of investment. [4]   * *Collective investment portfolios invest in a range of underlying assets and therefore help with diversification which minimises risk exposure.* * *Collective investment portfolios are a very convenient way of investing in markets which one would otherwise find difficult to access.* * *History has shown that average collective investment portfolio returns compare very favourably with returns from more traditional investment products.* * *Collective investment portfolios are liquid so one can cash in all or part of their investment at any time and have ready access to their money, often within 24 hours.* * *Compared to other investment vehicles, collective investment portfolios are tax effective in terms of Capital Gains Tax (CGT) as they are exempt from paying CGT.* |
| **Question 25 (14 marks)**  Study the given list of assets in the table below:   |  |  | | --- | --- | | Primary residence | R3 000 000 | | Cars | R 700 000 | | Share portfolio | R2 000 000 | | Holiday flat (no rental income; to be inherited by owner’s son) | R2 000 000 | | Money market | R 500 000 | | Pension preservation fund | R8 000 000 | | Retirement annuity | R 400 000 | | Gold coins | R 200 000 |   a) Calculate the total value of the portfolio. [1]  *Total portfolio is R16 800 000.*  b) Subdivide the assets according to the following three portfolios: [8]  - Lifestyle assets  - Discretionary assets  - Retirement – or compulsory assets  ***Lifestyle assets***  *Primary residence*  *Cars*  *Holiday flat (no rental income; to be inherited by owner’s son)*  ***Discretionary assets***  *Share portfolio*  *Money market*  *Gold coins*  ***Retirement or compulsory assets***  *Pension preservation fund*  *Retirement annuity*  c) Assume the above portfolio belongs to Mr A (58 years), who plans to retire in two years, although his current retirement savings are not enough to meet his retirement income needs assuming he lives to be 90 years, he believes he has enough assets to see him through.  Based on the assets in his portfolio, is he correct in assuming he has enough assets to see him through the period of retirement? [3]  The assumption that he will have sufficient assets may be true if he decides to keep the shares so that he continues to earn dividend income. He may also have to consider renting out the holiday home to generate rental income.  With funds from the money market as well as part of proceeds from the retirement annuity, he can buy an apartment which he can rent out to generate income.  d) It can be to an investor’s advantage to invest in a property unit trust fund, rather than buying a property directly. Justify this statement by giving any advantages of a property unit trust. [2]   * *Diverse properties in a single portfolio – risk is less* * *Will be easier (and faster) to sell the units – liquidity* * *Possible to sell only a few units – cannot sell a portion of the property* * *Rental income vs Interest income* * *Costs of selling property* |