

PGDM, 2019-20
Financial Planning and Wealth Management
DM-512/IB - 513
Trimester –IV, End-Term Examination: December 2019

Time allowed: 2 Hrs 30 Min

Max Marks: 50

Roll No: _____

Instruction: Students are required to write Roll No on every page of the question paper, writing anything except the Roll No will be treated as **Unfair Means**. All other instructions on the reverse of Admit Card should be followed meticulously. Please carry a non-programmable calculator.

Section: A (30 Marks).

Attempt all the 3 questions, each question carries 10 marks.

1. a) "Insurance contracts are subject to 'Utmost good faith' – Discuss this statement critically. (CILO 2) (5)

b) 'Investible surplus, behavioural profile, and financial goals should sync with one another during the financial planning processes' – Discuss this statement critically. (CILO 2) (5)

OR

1. Ashok, a middle level executive, aged 45 years saves at 9% pa Rs. 200000 in the beginning of a year for the first 8 years and then stops saving on account of certain financial contingencies. On retirement at the age of 65 years, he intends to keep aside a sum of Rs. 500000 out of the accumulated amount of the above savings as liquid money for emergencies and to invest the balance amount at 6% pa providing withdrawal of a fixed amount at the end of every year for 20 years. Find the amount of annual withdrawals. (10) (CILO 2)

2. a) Critically explain the differences between 'cognitive biases' and 'emotional biases'. (5)
b) According to Pompian (2011), which biases are more predominant among 'growth' behavioural investor types and 'aggressive' behavioural investor types? (CILO 1) (5)

OR

2. An employee aged 57 years wishes to purchase an annuity certain for 20 years starting from age 60 by paying single premium. Calculate the single premium payable now. The amount of annual annuity payment is Rs. 100000. First instalment is paid at the end of 3 years and

remaining at 1 year intervals thereafter. Assume interest to be 7 % pa during the deferment and the annuity payment period. (CILO 1) (10)

3. 'This is not surprising in itself and most would not disagree that the value added from active management is small (though important) relative to asset returns as a whole' as per Brinson, Hood, and Beebower (1995). Discuss critically. (CILO 3) (10)

OR

3. a) John aged 42 years working in a software company wants "nest eggs" amounting to Rs. 5000000 at his retirement age of 65 years. Assume rate of interest 10% p.a.

- i) How much amount should he save in the beginning of every year until retirement?
 - ii) Alternatively, how much amount should he save at the end of every year until retirement?
- (CILO 3) (5)

b) A has invested Rs. 1000 in a savings instrument maturing after 15 years. On its maturity, he receives a sum of Rs. 1750. What rate of interest is realised in this transaction? (CILO 3) (5)

Sec B
(Case Study; 20 marks; CILO 2/3)

4. Mr. Bimal who is aged 42 years has got a contractual assignment in UAE for a period of 15 years. He has been on his assignment for the past 4 years and has already saved Rs.7 lakh every year. He now plans to save Rs.10 lakh for the balance period of his assignment abroad and then come back to India and live a retired life.

- a) If his savings earn an interest of 7% pa during the accumulation stage, how much accumulated money will he have when he returns to India? (3)
- b) If his life expectancy is 85 years and the accumulated savings earn a return of 8% pa, how much money can he spend per annum to sustain himself for the balance period of his estimated life span? (3)
(Assumption: calculation on annuity due basis)
- c) If the estimated expenses for his family are Rs.3,60,000 pa and the rate of inflation is 6%, then how long will his accumulated savings last? (3)
- d) If his contract is extended for a further period of 5 years and he is in a position to save Rs.12 lakh per year during this extended period of stay, how much will he accumulate by the time he returns to India? (3)
(Assume that his savings earn a return of 7% pa throughout the period of total stay abroad.)
- e) Under the changed circumstances as narrated in (d) above, how much money per annum is available for household expenses during his balance life span if the impact of inflation is ignored and his savings earn an interest of 6% during the disbursement period. (4)
- f) In the case of (d) above, how long will his money last if the estimated spend per annum for his family is Rs.5,00,000 on his return from abroad and the rate of inflation is 6.5% and the rate of interest is 7% during this period of retired life? (4)

PRESENT VALUE TABLE

Present value of \$1, that is $(1+r)^{-n}$ where r = interest rate; n = number of periods until payment or receipt.

Periods (n)	Interest rates (r)									
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239
16	0.853	0.728	0.623	0.534	0.458	0.394	0.339	0.292	0.252	0.218
17	0.844	0.714	0.605	0.513	0.436	0.371	0.317	0.270	0.231	0.198
18	0.836	0.700	0.587	0.494	0.416	0.350	0.296	0.250	0.212	0.180
19	0.828	0.686	0.570	0.475	0.396	0.331	0.277	0.232	0.194	0.164
20	0.820	0.673	0.554	0.456	0.377	0.312	0.258	0.215	0.178	0.149

Periods (n)	Interest rates (r)									
	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833
2	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694
3	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579
4	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482
5	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402
6	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335
7	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279
8	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233
9	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194
10	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162
11	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135
12	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112
13	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093
14	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078
15	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.079	0.065
16	0.188	0.163	0.141	0.123	0.107	0.093	0.081	0.071	0.062	0.054
17	0.170	0.146	0.125	0.108	0.093	0.080	0.069	0.060	0.052	0.045
18	0.153	0.130	0.111	0.095	0.081	0.069	0.059	0.051	0.044	0.038
19	0.138	0.116	0.098	0.083	0.070	0.060	0.051	0.043	0.037	0.031
20	0.124	0.104	0.087	0.073	0.061	0.051	0.043	0.037	0.031	0.026

Cumulative present value of \$1 per annum, Receivable or Payable at the end of each year for n years $\frac{1-(1+r)^{-n}}{r}$

Periods (n)	Interest rates (r)									
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909
2	1.970	1.942	1.913	1.886	1.859	1.833	1.808	1.783	1.759	1.736
3	2.941	2.884	2.829	2.775	2.723	2.673	2.624	2.577	2.531	2.487
4	3.902	3.808	3.717	3.630	3.546	3.465	3.387	3.312	3.240	3.170
5	4.853	4.713	4.580	4.452	4.329	4.212	4.100	3.993	3.890	3.791
6	5.795	5.601	5.417	5.242	5.076	4.917	4.767	4.623	4.486	4.355
7	6.728	6.472	6.230	6.002	5.786	5.582	5.389	5.206	5.033	4.868
8	7.652	7.325	7.020	6.733	6.463	6.210	5.971	5.747	5.535	5.335
9	8.566	8.162	7.786	7.435	7.108	6.802	6.515	6.247	5.995	5.759
10	9.471	8.983	8.530	8.111	7.722	7.360	7.024	6.710	6.418	6.145
11	10.368	9.787	9.253	8.760	8.306	7.887	7.499	7.139	6.805	6.495
12	11.255	10.575	9.954	9.385	8.863	8.384	7.943	7.536	7.161	6.814
13	12.134	11.348	10.635	9.986	9.394	8.853	8.358	7.904	7.487	7.103
14	13.004	12.106	11.296	10.563	9.899	9.295	8.745	8.244	7.786	7.367
15	13.865	12.849	11.938	11.118	10.380	9.712	9.108	8.559	8.061	7.606
16	14.718	13.578	12.561	11.652	10.838	10.106	9.447	8.851	8.313	7.824
17	15.562	14.292	13.166	12.166	11.274	10.477	9.763	9.122	8.544	8.022
18	16.398	14.992	13.754	12.659	11.690	10.828	10.059	9.372	8.756	8.201
19	17.226	15.679	14.324	13.134	12.085	11.158	10.336	9.604	8.950	8.365
20	18.046	16.351	14.878	13.590	12.462	11.470	10.594	9.818	9.129	8.514

Periods (n)	Interest rates (r)									
	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833
2	1.713	1.690	1.668	1.647	1.626	1.605	1.585	1.566	1.547	1.528
3	2.444	2.402	2.361	2.322	2.283	2.246	2.210	2.174	2.140	2.106
4	3.102	3.037	2.974	2.914	2.855	2.798	2.743	2.690	2.639	2.589
5	3.696	3.605	3.517	3.433	3.352	3.274	3.199	3.127	3.058	2.991
6	4.231	4.111	3.998	3.889	3.784	3.685	3.589	3.498	3.410	3.326
7	4.712	4.564	4.423	4.288	4.160	4.039	3.922	3.812	3.706	3.605
8	5.146	4.968	4.799	4.639	4.487	4.344	4.207	4.078	3.954	3.837
9	5.537	5.328	5.132	4.946	4.772	4.607	4.451	4.303	4.163	4.031
10	5.889	5.650	5.426	5.216	5.019	4.833	4.659	4.494	4.339	4.192
11	6.207	5.938	5.687	5.453	5.234	5.029	4.836	4.656	4.486	4.327
12	6.492	6.194	5.918	5.660	5.421	5.197	4.988	4.793	4.611	4.439
13	6.750	6.424	6.122	5.842	5.583	5.342	5.118	4.910	4.715	4.533
14	6.982	6.628	6.302	6.002	5.724	5.468	5.229	5.008	4.802	4.611
15	7.191	6.811	6.462	6.142	5.847	5.575	5.324	5.092	4.876	4.675
16	7.379	6.974	6.604	6.265	5.954	5.668	5.405	5.162	4.938	4.730
17	7.549	7.120	6.729	6.373	6.047	5.749	5.475	5.222	4.990	4.775
18	7.702	7.250	6.840	6.467	6.128	5.818	5.534	5.273	5.033	4.812
19	7.839	7.366	6.938	6.550	6.198	5.877	5.584	5.316	5.070	4.843
20	7.963	7.469	7.025	6.623	6.259	5.929	5.628	5.353	5.101	4.870

FORMULAE

PROBABILITY

$A \cup B = \mathbf{A \text{ or } B}$. $A \cap B = \mathbf{A \text{ and } B}$ (overlap).

$P(B | A)$ = probability of B, given A.

Rules of Addition

If A and B are mutually exclusive: $P(A \cup B) = P(A) + P(B)$

If A and B are **not** mutually exclusive: $P(A \cup B) = P(A) + P(B) - P(A \cap B)$

Rules of Multiplication

If A and B are *independent*: $P(A \cap B) = P(A) * P(B)$

If A and B are **not** independent: $P(A \cap B) = P(A) * P(B | A)$

$E(X) = \sum (\text{probability} * \text{payoff})$

DESCRIPTIVE STATISTICS

Arithmetic Mean

$$\bar{x} = \frac{\sum x}{n} \quad \bar{x} = \frac{\sum fx}{\sum f} \quad (\text{frequency distribution})$$

Standard Deviation

$$SD = \sqrt{\frac{\sum(x - \bar{x})^2}{n}} \quad SD = \sqrt{\frac{\sum fx^2}{\sum f} - \bar{x}^2} \quad (\text{frequency distribution})$$

INDEX NUMBERS

Price relative = $100 * P_1/P_0$

Quantity relative = $100 * Q_1/Q_0$

Price:
$$\frac{\sum w * \left(\frac{P_1}{P_0}\right)}{\sum w} * 100$$

Quantity:
$$\frac{\sum w * \left(\frac{Q_1}{Q_0}\right)}{\sum w} * 100$$

TIME SERIES

Additive Model

Series = Trend + Seasonal + Random

Multiplicative Model

Series = Trend * Seasonal * Random

FINANCIAL MATHEMATICS

Compound Interest (Values and Sums)

Future Value S , of a sum of X , invested for n periods, compounded at $r\%$ interest

$$S = X[1 + r]^n$$

Annuity

Present value of an annuity of £1 per annum receivable or payable for n years, commencing in one year, discounted at $r\%$ per annum:

$$PV = \frac{1}{r} \left[1 - \frac{1}{[1 + r]^n} \right]$$

Perpetuity

Present value of £1 per annum, payable or receivable in perpetuity, commencing in one year, discounted at $r\%$ per annum:

$$PV = \frac{1}{r}$$

LEARNING CURVE

$$Y_x = aX^b$$

where:

Y_x = the cumulative average time per unit to produce X units;

a = the time required to produce the first unit of output;

X = the cumulative number of units;

b = the index of learning.

The exponent b is defined as the log of the learning curve improvement rate divided by log 2.

INVENTORY MANAGEMENT

Economic Order Quantity

$$EOQ = \sqrt{\frac{2C_o D}{C_h}}$$

where: C_o = cost of placing an order
 C_h = cost of holding one unit in Inventory for one year
 D = annual demand