STRATHMORE BUSINESS SCHOOL

BACHELOR OF FINANCIAL SERVICES

SPECIAL EXAMINATION

FSE 4201: BEHAVIORAL FINANCE

DATE: Thursday, 7th May 2026 **TIME:** 10:00 – 12:00

Instructions

1. This examination consists of **FIVE** questions.
2. Answer **Question ONE (COMPULSORY)** and any other **TWO** questions.

QUESTION ONE

Read the **Case study** below and answer the questions that follow:

Case Study: Horizon Wealth Advisors (Advanced Advisory Context)

You are a senior advisor at Horizon Wealth Advisors. Your firm integrates Behavioral Investor Types (BIT) with risk profiling and portfolio construction constraints.

You are assigned four clients:

Client W: Alice – Near retirement, highly loss-averse, frequently seeks reassurance, resists rebalancing even when her portfolio becomes suboptimal.

Client X: Brian – Influenced by peer networks and online platforms. His stated risk tolerance is inconsistent with his actual behavior during volatility.

Client Y: Carol – Highly analytical, rejects advice unless fully justified, attributes success to her own skill, and selectively interprets data.

Client Z: David – Actively trades, uses leverage occasionally, believes he can consistently outperform the market, and increases risk after gains

Required

i. Classify each client into the appropriate Behavioral Investor Type, justify using both behavioral traits and risk characteristics **(12 marks)**

ii. For each client: identify two primary behavioral biases associated with each BIT and explain how these biases may distort portfolio construction or asset allocation decisions? **(10 marks)**

iii. Recommend one tailored portfolio or advisory intervention per client, ensuring alignment with: behavioral profile and risk-return objectives **(4 marks)**

a) Multiple choice questions: Each 1 mark

i. Which bias most directly leads to suboptimal diversification despite available information?

A. Mental accounting
B. Loss aversion
C. Regret aversion

ii. A mismatch between stated and revealed risk tolerance is best explained by:

A. Framing effects
B. Behavioral inconsistency
C. Anchoring

iii. Which heuristic is most likely to cause overreaction to recent market news?

A. Representativeness
B. Availability
C. Anchoring

iv. Which bias is most difficult to correct through education alone?

A. Cognitive bias
B. Emotional bias
C. Information-processing bias

TOTAL: 30 MARKS

QUESTION TWO

a) Read the case scenario below and answer the questions that follow:

Pension Fund Governance Failure

An investment committee approves a high allocation to infrastructure despite mixed analysis:

- Dominant leadership influence
- Suppression of dissent
- Over-reliance on recent success

Required:

i. Identify and explain **three** biases/group dynamics, linking each to decision-making theory. **(6 marks)**

ii. Analyze how these biases affect: information processing and governance quality **(5 marks)**

iii. Recommend **two** institutional mechanisms (not generic suggestions) to mitigate bias **(4 marks)**

TOTAL: 15 MARKS

QUESTION THREE

Case Scenario: Fintech Investment Committee Under Uncertainty
A SACCO is considering investing in a fintech platform with limited historical data:

"Competitors are already investing—we must act quickly."

"Recent success stories suggest exponential growth potential."

"We should wait for valuations to return to earlier benchmarks."

"I believe I evaluate these opportunities objectively."

Required:

i. Identify and explain **four** biases, ensuring at least: one cognitive bias and one emotional bias? **(8 marks)**
ii. Critically evaluate how interaction of these biases (not individually) could amplify decision errors **(4 marks)**
iii. Design **two** structured decision rules or frameworks (not generic suggestions) to reduce bias **(3 marks)**

TOTAL: 15 MARKS

QUESTION FOUR

a) Read the case extract below and answer the questions that follow:

Performance Attribution and Market Narratives
A fund manager attributes strong returns to skill and recommends increased exposure. After losses, she reframes outcomes as unpredictable despite earlier confidence.

Required

i. Explain **three** interacting biases, emphasizing causal links between them? **(6 marks)**
ii. Assess how these biases affect: risk-taking behavior, client communication quality **(4 marks)**

b) Multiple choice based on the case scenario below:

An investor:

- Sells winners early
- Holds losers too long

- Evaluates investments independently

Required

i. The combined behavior is best described as: **(1 mark)**
   a) Disposition effect
   b) Overconfidence
   c) Herding

ii. The portfolio-level failure arises from: **(2 marks)**
   a) Framing and mental accounting
   b) Anchoring and availability
   c) Herding and regret aversion

iii. The most effective intervention is **(2 marks)**
   a) Enforcing systematic rebalancing rules
   b) Increasing trading frequency
   c) Focusing on past returns

TOTAL: 15 MARKS

QUESTION FIVE

Read the **Case scenario** below and answer the questions that follow:

Tactical Asset Allocation Decision

An advisor delays market entry based on:

- Extended market rally
- Seasonal patterns
- Historical reversal probabilities

Required:

i. Identify **three** biases and distinguish whether each is: heuristic-driven or belief perseverance **(6 marks)**

ii. Explain how reliance on these biases introduces: timing risk and opportunity cost **(4 marks)**

iii. Recommend **two** quantitatively grounded approaches (not purely qualitative) to improve decisions. **(5 marks)**

TOTAL: 15 MARKS