AF4

Advanced Diploma in Financial Planning

Unit AF4 – Investment planning

March 2025 examination

SPECIAL NOTICES
All questions in this paper are based on English law and practice applicable in the tax year 2024/2025, unless stated otherwise in the question, and should be answered accordingly.
It should be assumed that all individuals are domiciled and resident in the UK unless otherwise stated.

Instructions

- Three hours are allowed for this paper.
- **Do not begin writing until the invigilator instructs you to.**
- **Read the instructions on page 3 carefully before answering any questions.**
- Provide the information requested on the answer book and form B.
- You are allowed to write on the inside pages of this question paper, but you must **NOT** write your name, candidate number, PIN or any other identification anywhere on this question paper.
- The answer book and this question paper must **both be handed in personally by you** to the invigilator before you leave the examination room. **Failure to comply with this regulation will result in your paper not being marked and you may be prevented from entering this examination in the future.**

Unit AF4 – Investment planning

Instructions to candidates

Read the instructions below before answering any questions

- **Three hours** are allowed for this paper which carries a total of 160 marks as follows:

- Section A: 80 marks
- Section B: 80 marks

- You are advised to spend approximately 90 minutes on Section A and 90 minutes on Section B.

- You are strongly advised to attempt **all** questions to gain maximum possible marks. The number of marks allocated to each question part is given next to the question and you should spend your time in accordance with that allocation.

- Read carefully all questions and information provided before starting to answer. Your answer will be marked strictly in accordance with the question set.

- You may find it helpful in some places to make rough notes in the answer booklet. If you do this, you should cross through these notes before you hand in the booklet.

- It is important to show all steps in a calculation, even if you have used a calculator.

- If you bring a calculator into the examination room, it must be a silent, battery or solar-powered, non-programmable calculator. The use of electronic equipment capable of being programmed to hold alphabetic or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements.

- Tax tables are provided at the back of this question paper.

- Answer each question on a new page and leave six lines blank after each question part.

Subject to providing sufficient detail you are advised to be as brief and concise as possible, using note format and short sentences on separate lines wherever possible.

SECTION A

This question is compulsory and carries 80 marks

Question 1

Read carefully all information provided in the case study before attempting the questions. Your answers should take into account the client's circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c), (d), (e), (f), (g) and (h) which follow.

Anna, aged 49, is a research chemist. She is employed on a salary of £70,000 per annum. Over the past two decades, she has invested in various UK equities, both on a direct basis and within a Stocks and Shares ISA.

Details of her overall portfolio are set out in **Table 1** below:

Table 1

Asset	Current value £	Current gross yield
Direct UK equities	70,000	2.8%
Stocks and Shares ISA (direct UK equities)	190,000	4.3%
Stocks and Shares ISA (money market fund)	20,100	-
Current and deposit accounts	30,000	3.1%

Prior to this year, Anna had not had a financial adviser. She has instead based her investment decisions on articles she has read as part of her work, and conversations with friends and colleagues who have made similar investments. Anna has invested exclusively in pharmaceutical companies based upon their announcements of new discoveries or medical breakthroughs, believing that a company's success will be repeated in the future. Anna has no formalised attitude to risk.

Anna recently had an initial meeting with Jens, a financial adviser within an authorised advisory firm. Having outlined her financial circumstances, Anna has stated that there are two specific areas that she would like to explore in greater detail. Firstly, she is concerned at her reliance upon investment in individual companies. However, she does not want to stop investing in pharmaceutical companies and Jens has mentioned that a thematic collective fund could meet her needs. Jens has highlighted one actively-managed open-ended investment company (OEIC), Future Medical Trends, although he has commented that the fund's alpha may warrant further analysis.

Financial information on this fund is set out in **Table 2** below:

Table 2

Fund return	Index return	Beta	Risk-free rate	Standard deviation
10.4%	9.2%	1.6	3.75%	1.7

Secondly, as a result of reading about deficits in the economy, Anna invested this tax year's ISA subscription into a money market fund, believing this is the same as holding cash. However, she has noticed that the fund manager uses a derivatives overlay to increase performance and protect against downside volatility.

Anna takes an interest in financial matters but is confused by much of the commentary she reads from the Bank of England, as she believes that its sole function is to set interest rates. She has asked Jens to explain this to her in more detail.

One of the equities held within the ISA, Chemotaxis Receptor plc, has recently announced it intends to commence paying an interim as well as the existing final dividend. Chemotaxis Receptor plc's share price has also risen sharply over the past three months, despite the FTSE SmallCap Index in which it sits having fallen over the same period.

Anna has previously not taken any income from her portfolio, with any dividends and interest being re-invested. However, going forward she would like to receive this income.

Questions

To gain maximum marks for calculations you ***must*** *show* ***all*** *your workings and express your answer to* ***two*** *decimal places.*

(a) Identify **five** client-related factors that Jens would discuss with Anna to help establish her attitude to risk. *Exclude time horizon/retirement date from your answer.* **(5)**

(b) **(i)** Explain **two** relative differences between what is measured by beta and what is measured by alpha. **(4)**

(ii) Calculate, **showing all your workings**, the alpha for the Future Medical Trends fund. **(6)**

(iii) Comment on what can be deduced from the alpha figure calculated in **part (b)(ii)** above and the performance of the fund. **(5)**

(c) **(i)** State **four** benefits of investing in a thematic or trend-based fund. **(4)**

(ii) State **four** drawbacks of investing in a thematic or trend-based fund. **(4)**

(d) **(i)** State the **two** main types of money market fund and identify the key differences in the weighted average maturity and weighted average life of their respective assets. **(6)**

(ii) Outline briefly the **main** differences between futures and options derivatives. **(6)**

QUESTIONS CONTINUE OVER THE PAGE

(e) Identify **two** main investor biases that Anna is displaying and give **one** reason for **each** bias. **(4)**

(f) **(i)** Describe briefly what is meant by the term 'current account' in respect of the UK economy. **(3)**

(ii) Describe briefly what is meant by the term 'capital account' in respect of the UK economy. **(3)**

(iii) Describe **five** main roles and functions of a central bank. *Exclude setting monetary policy from your answer*. **(5)**

(g) Calculate, **showing all your workings**, the net income that Anna could generate from **each** of her portfolio assets if she decided to take the interest and dividends. **(13)**

(h) **(i)** Explain briefly **three** main differences between an interim and fixed dividend. **(6)**

(ii) Identify **six** factors that would cause the significant increase in Chemotaxis Receptor's share price. *Exclude the increase in dividend from your answer.* **(6)**

Total marks available for this question: 80

Section B questions can be found on pages 8 – 11

SECTION B

Both questions in this section are compulsory and carry an overall total of 80 marks

Question 2

Read carefully all information provided in the case study before attempting the questions. Your answers should take into account the clients' circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c), (d) and (e) which follow.

Brenno and Diane are new retail clients of an authorised advisory firm. They are married and are both chartered surveyors. Both are planning to retire at their respective State Pension ages and their forecasted State Pension and private pension plan income is sufficient to meet their planned fixed retirement expenditure. To provide for additional discretionary expenditure in retirement, they plan to use the capital held within their respective investment portfolios. Brenno and Diane each hold a number of collective funds on a platform.

Details of one fund held within each of their portfolios are set out in **Table 1** below:

Table 1

Owner	Fund Name	Value at 1st March 2021 £	Value as of 1st March 2025 £	10-year average nominal return
Brenno	UK Equity Tracker	25,205	35,500	6%
Diane	Global Equities Managed	29,946	48,300	8%
Total		55,151	83,800	-

While these funds were each set up initially with a £20,000 investment, Diane has noticed that the value of her fund has increased by a greater amount than Brenno's, particularly over the most recent four-year period. Diane has read in the fund manager's most recent commentary that the performance of Global Equities Managed has benefited from 'taking tactically overweight positions in the main US indices' and 'not subscribing to the Efficient Market Hypothesis in any form'. They would like to understand what is meant by these terms.

Brenno has a lower attitude to risk than Diane and prefers not to see the value of his portfolio fluctuate significantly in the short-term. However, having seen the difference in performance between the two funds, he is considering switching his investment, either into the same investment as Diane's, or into an alternative fund that may be more suitable.

Brenno and Diane have become increasingly aware of the impact of higher inflation. They would like to know what their investments might be worth in today's terms upon their retirement in 9 years' time. They believe that 3% is a reasonable annual inflation figure. The effects of inflation will be discussed with their financial adviser at a forthcoming review meeting, which will also include a rebalancing of their respective portfolios.

Questions

*To gain maximum marks for calculations you **must** show **all** your workings and express your answer to **two** decimal places.*

(a) **(i)** Describe briefly the main differences in the structure and composition of the Dow Jones Industrial Average Index and the Standard and Poor's 500 US stock market indices. **(4)**

(ii) Identify **four** reasons why a UK investor would consider investing in a US equities fund. **(4)**

(b) Describe briefly what is meant by the Strong form efficiency of the Efficient Market Hypothesis. **(5)**

(c) **(i)** Calculate, **showing all your workings**, the real value of Diane's fund at retirement. *Assume that the figures contained in the case study continue unchanged for the period until retirement.* **(5)**

(ii) Calculate, **showing all your workings**, the compound annual return of the total investment portfolio over the four-year period shown in **Table 1**. **(6)**

(d) Identify **four** reasons why switching to a volatility managed fund might be more suitable to Brenno than switching to the Global Equities Managed fund. **(4)**

(e) **(i)** State **three** factors relating to the rebalancing process that an adviser would consider when preparing to rebalance a portfolio held on a platform. **(3)**

(ii) State **three** investment-related factors that might trigger a need to rebalance a portfolio. **(3)**

(iii) Identify **three** main **benefits** of rebalancing a client's investment portfolio. **(3)**

(iv) Identify **three** main **drawbacks** of rebalancing a client's investment portfolio. **(3)**

Total marks available for this question: 40

Question 3

Read carefully all information provided in the case study before attempting the questions. Your answers should take into account the client's circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c), (d) and (e) which follow.

Marek, aged 66, is a retail client of an authorised advisory firm. He is due to retire within the next three months and has requested a meeting with his financial adviser, Theresa. Theresa has previously calculated Marek's gross income from his pension arrangements to be £27,500 per annum.

Marek's objective is income generation for the long-term. Having identified his gross total income need as £36,500, Theresa has calculated a target yield of 6.9% per annum from his investment portfolio. The portfolio consists of a directly-held government gilt and an investment grade corporate bond, which are held in a general investment account (GIA). Marek has a cautious attitude to risk.

Details of the two holdings are set out in **Table 1** below:

Table 1

	S&P credit rating	Current value £	Price £	Redemption date	Coupon
Gilt	AA	75,000	126.20	October 2034	5.6p
Corporate bond	BBB	55,000	98.30	April 2026	8.5p

In addition, Marek holds a small number of private company shares in one of his former employers, River Grey Logistics Ltd. The company used to be listed on the FTSE SmallCap Index but delisted several years ago. The shares are not held on the platform. Since then, Marek has continued to receive annual dividends. He does not know how much his shares may be worth. Theresa has suggested that it may be possible to calculate the share price using a dividend discount model.

Details of this shareholding are set out in **Table 2** below:

Table 2

Dividend	Return on equity	Return on capital employed
14.5p	18%	11%

An objective of the meeting will be to review the portfolio's composition and determine a sustainable withdrawal rate for Marek, in relation to the target yield and income from the GIA.

Questions

*To gain maximum marks for calculations you **must** show **all** your workings and express your answers to **two** decimal places.*

(a) **(i)** Describe briefly the main differences between the coupon, running yield and redemption yield of a fixed interest security. *No calculations are required.* **(7)**

(ii) Calculate, **showing all your workings**, the redemption yield for the gilt. *You should use the simplified method in your answer*. **(7)**

(b) Comment on Marek's target yield and the suitability of the fixed interest assets to meet his income need. **(5)**

(c) Identify **five** investment-related factors that Theresa would take into consideration when assessing a sustainable withdrawal rate. **(5)**

(d) Identify **five** investment-specific risks to which Marek's investment portfolio within the GIA is exposed and give **one** reason for each risk. **(10)**

(e) **(i)** Calculate, **showing all your workings**, the theoretical share price for River Grey Logistics Ltd using the dividend discount model. **(3)**

(ii) Identify **three** factors that should be taken into consideration when using a dividend discount model. **(3)**

Total marks available for this question: 40

The tax tables can be found on pages 13 – 19

INCOME TAX

RATES OF TAX	2023/2024	2024/2025
Starting rate for savings*	0%	0%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	45%	45%
Starting-rate limit	£5,000*	£5,000*
Threshold of taxable income above which higher rate applies	£37,700	£37,700
Threshold of taxable income above which additional rate applies	£125,140	£125,140
High income child benefit charge: 1% of benefit per £200 of adjusted net income between £60,000 – £80,000		

**Only applicable to savings income that falls within the first £5,000 of income in excess of the personal allowance.*

	2023/2024	2024/2025
Personal savings allowance (for savings income):		
Basic rate taxpayers	£1,000	£1,000
Higher rate taxpayers	£500	£500
Additional rate taxpayers	Nil	Nil
Dividend Allowance	£1,000	£500
Dividend tax rates		
Basic rate	8.75%	8.75%
Higher rate	33.75%	33.75%
Additional rate	39.35%	39.35%
Trusts		
Standard rate band	£1,000	n/a
Income exemption up to**	n/a	£500
Rate applicable to trusts		
- dividends	39.35%	39.35%
- other income	45%	45%

*** Where net income exceeds £500, the full amount is subject to Income Tax.*

MAIN PERSONAL ALLOWANCES AND RELIEFS	2023/2024	2024/2025
Income limit for Personal Allowance §	£100,000	£100,000
Personal Allowance (basic) §	£12,570	£12,570
Married/civil partners (minimum) at 10% †	£4,010	£4,280
Married/civil partners at 10% †	£10,375	£11,080
Marriage Allowance	£1,260	£1,260
Income limit for Married Couple's Allowance†	£34,600	£37,000
Rent a Room scheme – tax free income allowance	£7,500	£7,500
Blind Person's Allowance	£2,870	£3,070
Enterprise Investment Scheme relief limit on £2,000,000 max***	30%	30%
Seed Enterprise Investment relief limit on £200,000 max	50%	50%
Venture Capital Trust relief limit on £200,000 max	30%	30%

§ The Personal Allowance reduces by £1 for every £2 of income above the income limit irrespective of age (under the income threshold).

† where at least one spouse/civil partner was born before 6 April 1935. Married couple's/civil partners' allowance reduced by £1 for every £2 of adjusted net income over £37,000 (£34,600 for 23/24) until minimum reached.
**** Investment above £1,000,000 must be in knowledge-intensive companies.*

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	Weekly
Lower Earnings Limit (LEL)	£123
Primary threshold	£242
Upper Earnings Limit (UEL)	£967

Total earnings £ per week	CLASS 1 EMPLOYEE CONTRIBUTIONS
Up to 242.00*	Nil
242.00 – 967.00	8%
Above 967.00	2%

**This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £123 per week. This £123 to £242 band is a zero-rate band introduced in order to protect lower earners' rights to contributory State benefits e.g. the New State Pension.*

Total earnings £ per week	CLASS 1 EMPLOYER CONTRIBUTIONS
Below 175.00**	Nil
Over £175.00	13.8%

***Secondary threshold.*

CLASS 2 (self-employed)*

Flat rate per week	£3.45
Small profits threshold per year	£6,725

Class 2 contributions are credited automatically where profits equal or exceed £6,725 per annum.
Class 2 contributions can be made voluntarily where profits are below £6,725 per annum.

Class 3 (voluntary)	Flat rate per week £17.45.
Class 4 (self-employed)	6% on profits between £12,570 and up to £50,270. 2% on profits above £50,270.

PENSIONS

TAX YEAR	LIFETIME ALLOWANCE
2012/2013 & 2013/2014	£1,500,000
2014/2015 & 2015/2016	£1,250,000
2016/2017 & 2017/2018	£1,000,000
2018/2019	£1,030,000
2019/2020	£1,055,000
2020/2021 – 2023/2024*	£1,073,100

**Lifetime allowance removed from 6 April 2024.*

	2023/2024	2024/2025
Lump sum and death benefit allowance (LSDBA)	n/a	£1,073,100
Lump sum allowance (LSA)	n/a	£268,275

LSA and LSDBA may be higher if transitional protections are available.
Where pension benefits were crystallised prior to 6 April 2024 the LSA and LSDBA may be reduced.

Money purchase annual allowance	£10,000	£10,000

ANNUAL ALLOWANCE

TAX YEAR	ANNUAL ALLOWANCE
2014/2015 – 2022/2023	£40,000*
2023/2024	£60,000**
2024/2025	£60,000**

**From 6 April 2016 the annual allowance is reduced for those with income above a certain level. Between 2020/21 and 2022/23 the annual allowance will be reduced by £1 for every £2 of 'adjusted income' over £240,000 to a minimum of £4,000 if 'threshold income' is also over £200,000.*

***Reducing by £1 for every £2 of 'adjusted income' over £260,000 to a minimum of £10,000 if 'threshold income' is also over £200,000.*

ANNUAL ALLOWANCE CHARGE

20% – 45% determined by the member's taxable income and the amount of total pension input in excess of the annual allowance or money purchase annual allowance.

CAPITAL GAINS TAX

ANNUAL EXEMPTIONS	2023/2024	2024/2025
Individuals, estates etc	£6,000	£3,000
Trusts generally	£3,000	£1,500
Chattels proceeds (restricted to five thirds of proceeds exceeding limit)	£6,000	£6,000

TAX RATES		Pre	Post
		30/10/2024	
Individuals:			
Up to basic rate limit	10%	10%	18%
Above basic rate limit	20%	20%	24%
Surcharge for residential property - Basic Rate	8%	8%	n/a
Higher Rate	8%	4%	n/a
Surcharge for carried interest	8%	8%	4%
Trustees and Personal Representatives:			
Residential property	28%	24%	24%
Other chargeable assets	20%	20%	24%
Business Asset Disposal Relief*	10%	10%	
Lifetime limit	£1,000,000	£1,000,000	

**For trading businesses and companies (minimum 5% employee or director shareholding) if held for at least two years.*

INHERITANCE TAX

RATES OF TAX ON TRANSFERS	2023/2024	2024/2025
Transfers made on death		
- Up to £325,000	Nil	Nil
- Excess over £325,000	40%	40%
- Reduced rate (where appropriate charitable contributions are made)	36%	36%
Transfers		
- Lifetime transfers to and from certain trusts	20%	20%

MAIN EXEMPTION		
Transfers to		
- UK-domiciled spouse/civil partner	No limit	No limit
- non-UK-domiciled spouse/civil partner (from UK-domiciled spouse)	£325,000	£325,000
- main residence nil rate band*	£175,000	£175,000
- UK-registered charities	No limit	No limit

**Available for estates up to £2,000,000 and then tapered at the rate of £1 for every £2 in excess until fully extinguished.*

Lifetime transfers		
- Annual exemption per donor	£3,000	£3,000
- Annual small gifts exemption per donor	£250	£250

Gifts from surplus income are immediately exempt, as long as they are made from income, are made regularly and do not impact donor's standard of living.

Wedding/civil partnership gifts by		
- parent	£5,000	£5,000
- grandparent/bride and/or groom	£2,500	£2,500
- other person	£1,000	£1,000

100% relief: businesses, unlisted/AIM companies, certain farmland/building
50% relief: certain other business assets

Reduced tax charge on gifts made in excess of the nil rate band within 7 years of death:

- Years before death	0-3	3-4	4-5	5-6	6-7
- Inheritance Tax payable	100%	80%	60%	40%	20%

Quick succession relief:

- Years since IHT paid	0-1	1-2	2-3	3-4	4-5
- Inheritance Tax relief	100%	80%	60%	40%	20%

MAIN SOCIAL SECURITY BENEFITS

		2023/2024	2024/2025
		£	£
Child Benefit	First child	24.00	25.60
	Subsequent children	15.90	16.95
	Guardian's allowance	20.40	21.75
Employment and Support Allowance	Assessment Phase		
	Age 16 - 24	Up to 67.20	Up to 71.70
	Aged 25 or over	Up to 84.80	Up to 90.50
	Main Phase		
	Work-related Activity Group	Up to 84.80*	Up to 90.50**
	Support Group	Up to 129.50	Up to 138.20
Attendance Allowance	Lower rate	68.10	72.65
	Higher rate	101.75	108.55
Basic State Pension	Category A full rate	156.20	169.50
	Category B (lower) full rate	93.60	101.55
New State Pension	Full rate	203.85	221.20
Pension Credit	Standard minimum guarantee - single	201.05	218.15
	Standard minimum guarantee - couple	306.85	332.95
	Maximum savings ignored in calculating income	10,000.00	10,000.00
Bereavement Support Payment	Higher rate – First payment	3,500.00	3,500.00
	Higher rate – monthly payment	350.00	350.00
	Lower rate – First payment	2,500.00	2,500.00
	Lower rate – monthly payment	100.00	100.00
Jobseeker's Allowance	Age 18 - 24	67.20	71.70
	Age 25 or over	84.80	90.50
Statutory Maternity, Paternity and Adoption Pay		172.48	184.03

**If a claim has begun before 3rd April 2017 the individual will also be awarded the Work-related Activity Component payment which in 2023/2024 is £33.70, so total awarded for these individuals may be up to £118.50.*

***If a claim has begun before 3rd April 2017 the individual will also be awarded the Work-related Activity Component payment which in 2024/2025 is £35.95, so total awarded for these individuals may be up to £126.45.*

CORPORATION TAX

	2023/2024	2024/2025
Small profit rate - for taxable profits below £50,000	19%	19%
Main rate - for taxable profits above £250,000	25%	25%

Companies with profits between £50,000 and £250,000 will pay tax at the main rate, reduced by a marginal relief. This provides a gradual increase in the effective Corporation Tax rate.

VALUE ADDED TAX

	2023/2024	2024/2025
Standard rate	20%	20%
Annual registration threshold	£85,000	£90,000
Deregistration threshold	£83,000	£88,000

STAMP DUTY LAND TAX

	Residential
Value up to £250,000	0%
£250,001 - £925,000	5%
£925,001 - £1,500,000	10%
£1,500,001 and over	12%

Additional Stamp Duty Land Tax (SDLT) rules apply as follows:

- *First-time buyers benefit from SDLT relief on first £425,000 for properties up to £625,000 when purchasing their mainresidence. On purchases up to £425,000, no SDLT is payable. On purchases between £425,001 and £625,000, a flat rate of 5% is charged on the balance above £425,000.*
- *Additional SDLT of 5% may apply to the purchase of additional residential properties purchased for £40,000 or greater.*
- *SDLT may be charged at 17% on interests in residential dwellings costing more than £500,000 purchased by certain corporate bodies or non-natural persons.*
- *SDLT is payable in England and Northern Ireland only. Land Transaction Tax(LTT) is payable in Wales and Land and Buildings Transaction Tax (LBTT) is payable in Scotland. Therates for LTT and LBTT are different to the rates shown above.*

	Non residential
Value up to £150,000	0%
£150,001 and £250,000	2%
£250,001 and over	5%

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