# BackDrop.docx Various Verbal Questions

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## Part FF Finance fundamentals and definitions (verbal questions)

### FF1 Who gets the economic profits

The traditional theory of finance argues that, on average and in the long run, true economic profits are distributed to whom? (this answer assumes perfectly competitive and efficient markets)

{ANSWER: E ; xlADDRESS: Conceptual!$B$253 }

/\a. exclusively to creditors

/\b. exclusively to management

/\c. equally between all capitalists and stakeholders

/\d. exclusively to labor

/\e. exclusively to capitalists

### FF2 Three sources of value

What are the three sources of financial value?

{ANSWER: C ; xlADDRESS: Conceptual!$B$262 }

/\a. arbitrage, hedging, and speculating

/\b. time value, investments, and financial planning

/\c. time value, transformation value, and arbitrage

/\d. investments, corporate finance, and institutions

/\e. financial accounting, risk & insurance, and real estate

### FF28 (T/F) What is the source of value when a company creates value

One often hears that a successful company creates value. This means that the value of the good or service the company produces exceeds the value of the factor inputs the company purchases. Is this statement True or False: the source of this value according to financial science is transformation value.

{ANSWER: A ; xlADDRESS: Conceptual!$B$1430 }

/\a. True b. False

### FF32 Describe the Board of Directors

Which statement most accurately describe the members on the Board of Directors?

{ANSWER: E ; xlADDRESS: Conceptual!$B$1616 }

/\a. They usually are not employees of the company

/\b. They often are successful outsiders with careers unrelated to the mission of the company

/\c. They are elected to the Board by shareholders

/\d. Two choices, A and B, are correct

/\e. The three A-B-C choices are all correct

### FF29 Corporate pyramid characteristics

The typical management hierarchy is a pyramid headed by the Board of Directors. Underneath that are senior management, including the Chief Executive Office (CEO) and Chief Financial Officer (CFO). Which statement is most consistent with the textbook discussion.

{ANSWER: B ; xlADDRESS: Conceptual!$B$1483 }

/\a. The Office of the Controller typically administers the finance functions of the firm.

/\b. The Office of the Treasurer typically administers the finance functions of the firm.

/\c. Besides the CEO, the next single-most important member of the senior management team is the CFO.

/\d. Two choices, A and C, are correct

/\e. The three A-B-C choices are all correct

### FF19 what are the 3 traditional subdisciplines of finance

What are the 3 traditional sub-disciplines of finance?

{ANSWER: C ; xlADDRESS: Conceptual!$B$271 }

/\a. banking, insurance, and real estate

/\b. stocks, bonds, and options

/\c. corporate finance, investments, and markets & institutions

/\d. balance sheet analysis, income statement analysis, and cash flow analysis

/\e. valuation, cash flow analysis, and security markets

### FF25 Categorization of financial markets

Choose the one statement that most correctly describes categorization schemes of the financial markets.

{ANSWER: E ; xlADDRESS: Conceptual!$B$1234 }

/\a. the secondary market includes stocks and bonds issued by the company to investors

/\b. the credit market includes stocks that do not specify repayment schedules but instead represent a claim on residual cash flows

/\c. the distinguishing criterion when categorizing markets as either money market or capital market is whether the security is new or used (seasoned)

/\d. the length of the financial contract is the distinguishing criterion when categorizing markets as either credit market or equity market

/\e. the money market includes financial securities repayable within one year

### FF20 Principal-agent relation and contested wealth

Which statement is most consistent with one or more of the principal-agent relationships that exist in corporate finance?

{ANSWER: A ; xlADDRESS: Conceptual!$B$280 }

/\a. shareholders are principals, management is the agent, and the contested wealth is equity

/\b. management/shareholders are the principals, creditor/bondholders are the agents, and the contested wealth is loans and debt

/\c. management/shareholders are the principals, employees are the agents, and the contested wealth is pension contributions

/\d. Two choices, A and B, are correct

/\e. The three A-B-C choices are all correct

### FF3 Agency costs borne by shareholders

Which of the following is an agency cost borne by shareholders?

{ANSWER: A ; xlADDRESS: Conceptual!$B$289 }

/\a. costs incurred in order to make management work towards the shareholder's best interests.

/\b. costs incurred because agents such as investment bankers must be hired to sell new equity issues.

/\c. costs arising from losses from risky investments that managers make on behalf of shareholders

/\d. costs paid to be in compliance with regulations of federal agencies

/\e. wages paid to make employees work toward the bests interests of the firm

### FF4 Agency cost minimization mechanisms

Which of the following mechanisms does not provide managers with an incentive to act in shareholders’ best interests?

{ANSWER: A ; xlADDRESS: Conceptual!$B$298 }

/\a. a leveraged buyout of shares by managers

/\b. concentration of equity ownership by institutional investors

/\c. threat of corporate take-over by raiders

/\d. management contracts that link compensation to the shareprice

/\e. threat of firing by Board of Directors

### FF31 Company goal

According to the new view of corporate finance which statement provides the best description for the proper goal of the company?

{ANSWER: C ; xlADDRESS: Conceptual!$B$1600 }

/\a. maximize employee wages

/\b. maximize sales revenue

/\c. maximize wealth creation

/\d. maximize Net income

/\e. maximize the stock price

### FF5 Legal organizational form

Which one statement about the legal form of business is most consistent?

{ANSWER: A ; xlADDRESS: Conceptual!$B$558 }

/\a. A disadvantage of the sole proprietorship is that they generally do not offer easy transferability of ownership.

/\b. An advantage of the sole proprietorship is that they offer limited liability to the owner.

/\c. An advantage of the corporation is that it has relatively low organizational costs.

/\d. A disadvantage of the corporation is that they raise capital more easily.

/\e. An advantage of the corporation is that they are subject to relatively fewer government regulations.

### FF33 Describe double taxation

In the business sector of the US economy the topic of double taxation is very controversial. Choose the statement that most accurately describes this topic.

{ANSWER: D ; xlADDRESS: Conceptual!$B$1748 }

/\a. Double taxation refers to when US corporations pay taxes on profits, distribute the profits to capitalists, and then capitalists pay taxes on the distribution.

/\b. Economists persuasively argue that double-taxation enables government spending that makes the citizens safer and more secure.

/\c. Economic studies find that if double-taxation were abolished then payments from the business sector to stakeholders and capitalists would increase.

/\d. Two choices, A and C, are correct

/\e. The three A-B-C choices are all correct

### FF10 Mergers and wealth transfers

What usually happens when a raiding company takes over a target company?

{ANSWER: E ; xlADDRESS: Conceptual!$B$316 }

/\a. raider company shareholders generally lose wealth and target company shareholders lose wealth

/\b. there are no wealth transfers and so each shareholders’ wealth is unchanged

/\c. raider company shareholders generally gain wealth and target company shareholders lose wealth

/\d. raider company shareholders generally gain wealth and target company shareholders gain wealth

/\e. raider company shareholders generally lose wealth and target company shareholders gain wealth

### FF12 Compare ROE to shareholder ROR

Whenever the price-to-book ratio is constant then which is the most accurate comparison of the return on equity (= *Net incomet* / *Stockholders’ equityt-1*) with the stockholders’ market rate of return (= (*Sharepricet* + *Dividendt* ) / *Sharepricet-1*)?

{ANSWER: E ; xlADDRESS: Conceptual!$B$325 }

/\a. If the shareholder rate of return is smaller than the return on equity then the price to book ratio is smaller than one.

/\b. If the price to book ratio is smaller than one, the shareholder rate of return is smaller than the return on equity.

/\c. If the price to book ratio is bigger than one, the return on equity is smaller than the shareholder rate of return.

/\d. If the price to book ratio is smaller than one, the return on equity is bigger than the shareholder rate of return.

/\e. If the shareholder rate of return is smaller than the return on equity then the price to book ratio is bigger than one.

### FF9 Define market capitalization

A company’s market capitalization equals:

{ANSWER: E ; xlADDRESS: Conceptual!$B$334 }

/\a. total stockholders’ equity divided by number of shares outstanding

/\b. equity book value per share divided by market price per share

/\c. total assets divided by number of shares outstanding

/\d. market price per share divided by equity book value per share

/\e. number of shares outstanding times market price per share

### FF22 What are sources v. uses of funds

Which statement best describes how sources or uses of funds relate to asset or liability accounts on the balance sheet?

{ANSWER: E ; xlADDRESS: Conceptual!$B$83 }

/\a. a decrease in a liability account represents a source of funds

/\b. a decrease in an asset account represents a use of funds

/\c. an increase in an asset account represents a source of funds

/\d. Two choices, B and C, are correct

/\e. None of the A-B-C choices are correct

### FF21 T/F: relation between annual and quarterly financial statements

The company prepares quarterly financial statements four times a year and annual financial statements once a year. True or false: the annual income statement is identical to the fourth-quarter income statement.

{ANSWER: B ; xlADDRESS: Conceptual!$B$75 }

/\a. True b. False

### FF11 Effect of stock repurchase on balance sheet

ATT announced its intention to repurchase $4 billion of common stock from its shareholders. What is the most direct consequence of this corporate policy?

{ANSWER: A ; xlADDRESS: Conceptual!$B$343 }

/\a. Stockholders’ Equity decreases by $4 billion

/\b. Stockholders’ Equity increases by $4 billion

/\c. Total Assets increases by $4 billion

/\d. Total Assets decreases by $4 billion

/\e. The sum of Total Liabilities and Stockholders’ Equity decreases by $4 billion

### FF7 What does movement in price-to-book ratio mean

Which one statement is most consistent with a doubling of the equity price-to-book ratio over the previous two years?

{ANSWER: B ; xlADDRESS: Conceptual!$B$352 }

/\a. the company’s stock is twice as undervalued today compared to two years ago

/\b. the company’s shareprice over the past two years has risen twice as fast as equity book value

/\c. the company’s stock is twice as overvalued today compared to two years ago

/\d. equity book value over the past two years has risen twice as fast as the company’s shareprice

/\e. the equity book value understates asset values twice as much today compared to two years ago

### FF30 Cash budgeting discriminatory power for frequency

True or false: A quarterly cash budget can determine whether the company expects a surplus or deficit for the entire quarter but is incapable of determining external financing needs during any particular month.

{ANSWER: A ; xlADDRESS: Conceptual!$B$1504 }

/\a. True b. False

### FF13 Identify A random walk down Wall Street

What is *A Random Walk Down Wall Street*?

{ANSWER: B ; xlADDRESS: Conceptual!$B$361 }

/\a. a movie in which Kris Kristofferson portrays a New York drunk that accosts highly paid Wall Street professionals

/\b. a book by Burton Malkiel that proclaims a well-trained monkey throwing darts can pick stocks as well as highly paid Wall Street professionals

/\c. a book by Harry Markowitz that proclaims stock prices move in random patterns and consequently highly paid Wall Street professionals cannot consistently pick underlying price patterns

/\d. a book by Harry Markowitz that proclaims stock prices move in random patterns unrelated to corporate profits

/\e. a book by Burton Malkiel that proclaims highly paid Wall Street Professionals pick stocks based on random information sets and that success is a random outcome

### FF14 Which definition of the information set is consistent with the Efficient Market Hypothesis

The Efficient Market hypothesis (“EMH”) claims it is not possible to use an information set to consistently earn excess stock returns. Which statement about different forms of the information set is most accurate?

{ANSWER: C ; xlADDRESS: Conceptual!$B$571 }

/\a. for the weak form of the EMH the information set includes calendar, stock market, and all public and privately available data

/\b. for the semi-strong form of the EMH the information set includes calendar, stock market, and all public and privately available data

/\c. for the weak form of the EMH the information set includes calendar and stock market data

/\d. for the strong form of the EMH the information set includes calendar, stock market, and all publicly available data

/\e. for the weak form of the EMH the information set includes calendar, stock market, and all publicly available data

### FF27 Nuances of the EMH

Which statement is most consistent with the Efficient Market Hypothesis (“EMH”).

{ANSWER: A ; xlADDRESS: Conceptual!$B$1369 }

/\a. The financial market may be efficient with respect to one information event but not others.

/\b. The EMH argues that stock prices adjust to new information within two minutes of when the information becomes publicly available.

/\c. With efficient markets no trading strategy consistently earns positive economic profits because no investor consistently finds new information offering an advantage for predicting required rates of return.

/\d. Two choices, A and B, are correct

/\e. None of the A-B-C choices are correct

### FF18 Anomalies and the efficient market hypothesis

Each statement below matches observed behavior of stock returns with one form of the Efficient Markets Hypothesis (“EMH”). A statement is correct (i) if the description of stock returns is accurate and, furthermore, (ii) if the type of information in the statement corresponds to the form of EMH with the smallest possible information set. Which statement or statements is/are correct?

{ANSWER: C ; xlADDRESS: Conceptual!$B$433 }

/\a. end-of-year (January) stock returns violate the strong form EMH because they are consistently larger than average

/\b. stock returns following a surprise earnings announcement violate the weak form EMH because they continue the surprise trend

/\c. stock returns after a stock split support the semi-strong form EMH because they are average

/\d. Two choices, A and B, are correct

/\e. None of the A-B-C choices are correct

### FF17 Match this father of finance with the contribution (Malkiel, Markowitz, Graham)

Which statement correctly matches a historical figure in finance with the contribution?

{ANSWER: B ; xlADDRESS: Conceptual!$B$584 }

/\a. Benjamin Graham is the father of the efficient markets hypothesis

/\b. Benjamin Graham is the father of applied investment theory

/\c. Harry Markowitz is the father of the efficient markets hypothesis

/\d. Harry Markowitz is the father of applied investment theory

/\e. Burton Malkiel is the father of modern portfolio theory

### FF24 Father of finance (Sharpe, Graham, Markowitz, Malkiel)

Which statement correctly matches a historical figure in finance with the contribution?

{ANSWER: C ; xlADDRESS: Conceptual!$B$210 }

/\a. Burton Malkiel is the father of modern portfolio theory and the efficient frontier concept

/\b. Harry Markowitz is the father of the efficient market hypothesis

/\c. Benjamin Graham is the father of a scientific approach to applied investments

/\d. Benjamin Graham is the father of the efficient market hypothesis

/\e. Harry Markowitz is the father of a scientific approach to applied investments

### FF8 What are different types of asset-backed securities

Which statement about an asset-backed security is false?

{ANSWER: D ; xlADDRESS: Conceptual!$B$604 }

/\a. an asset-backed bond may give the bond-holder cash flows paid by homeowners on home mortgage loans

/\b. an asset-backed bond may give the bond-holder cash flows paid by homeowners toward loans on manufactured homes

/\c. an asset-backed bond may give the bond-holder cash flows paid by consumers toward automobile loans

/\d. an asset-backed bond may give the bond-holder cash flows paid by companies on loans financing pension expenditures

/\e. an asset-backed bond may give the bond-holder cash flows paid by college graduates on student loans

### FF26 Characteristics of asset-backed securities

Which statement about an asset-backed security is most accurate?

{ANSWER: C ; xlADDRESS: Conceptual!$B$1262 }

/\a. the balance sheet for an asset-backed issuer has assets such as asset-backed securities on the left-hand-side and liabilities such as mortgages on the right-hand-side

/\b. investors in asset-backed securities receive cash flows that, relatively speaking, are unpredictable like a stock instead of predictable like a bond

/\c. the value of outstanding asset-backed securities has grown from about $35 billion in 1985 to about $2 trillion now

/\d. more prominent markets for asset-backed securities include municipal bonds, corporate bonds, and government bonds

/\e. an asset-backed security represents a pool of many loans that are all very different types of loans

### FF15 Define arbitrage

An arbitrage strategy implies …

{ANSWER: B ; xlADDRESS: Conceptual!$B$379 }

/\a. an uncertain outcome earning less than the risk free rate

/\b. a certain outcome earning more than the risk free rate

/\c. an uncertain outcome earning more than the risk free rate

/\d. a certain outcome earning less than the risk free rate

/\e. an investment strategy that profits from uncertain price changes

### FF6 What is a basis point

By how many basis points does 4.3% differ from 7.9% ?

{ANSWER: C ; xlADDRESS: Conceptual!$B$538 }

/\a. 270 b. 240 c. 360 d. 310 e. 410

### FF23 Payback period disadvantages

The payback period assesses the quality of a cash flow stream. What are some general advantages and/or disadvantages of this assessment measure?

{ANSWER: A ; xlADDRESS: Conceptual!$B$150 }

/\a. the payback period ignores the time value of money

/\b. a short payback period is worse than a long payback period

/\c. the payback period measures cash flows occurring throughout the length of the entire cash flow stream

/\d. Two choices, A and B, are correct

/\e. The three A-B-C choices are all correct

### FF16 What is effect of exchange rate movements

Which of the following statements about exchange rate movements applies most accurately to a local company that exports its products abroad?

{ANSWER: B ; xlADDRESS: Conceptual!$B$388 }

/\a. a depreciating dollar lowers profit margins

/\b. a depreciating dollar helps export sales

/\c. an appreciating dollar helps reduce local labor costs

/\d. a depreciating dollar helps reduce local labor costs

/\e. a depreciating dollar hurts export sales

## Part BS Backdrop and institutional setting (verbal questions)

### BS3 Characteristics of IPO’s

Which one statement about initial public offerings (IPO’s) is false?

{ANSWER: D ; xlADDRESS: Conceptual!$B$397 }

/\a. shareprices for IPO stocks generally underperform the overall market during the few years following the IPO

/\b. information disclosure requirements increase after the company goes public

/\c. shareprices for IPO stocks generally rise dramatically during the first few days following the IPO

/\d. an IPO is the sale of insured stock to the public by large capitalization companies

/\e. IPO’s tend to diminish in frequency during general stock market declines

### BS4 Who gets the money left on the table in an IPO

Suppose a company sells shares at 9am through an Initial Public Offering at an offer price of $15. By noon, the share trades at $45. At the close of its first day of trading, the shareprice is $30. Which of the following statements is most accurate? (Ignore any commissions or fees paid to brokers and underwriters.)

{ANSWER: D ; xlADDRESS: Conceptual!$B$406 }

/\a. The company receives a cash inflow of $45 for each share sold.

/\b. The investor that purchased the stock at noon and sold it at the end of the day made a –67%% rate of return.

/\c. The investor that purchased the stock at its offer price and sold it at the end of the day made a 200% rate of return.

/\d. The investor that purchased the stock at its offer price and sold it at the end of the day made a 100% rate of return.

/\e. The company receives a cash inflow of $30 for each share sold.

### BS23 Initial public offering, 2 of 3 statements

Choose the most accurate statement about Initial Public Offerings (IPOs).

{ANSWER: C ; xlADDRESS: Conceptual!$B$415 }

/\a. shareprices for IPOs during the first day of trading rise dramatically for some stocks, fall for others, but on average follow the overall market

/\b. shareprices for IPO stocks generally overperform the overall market during the few years following the IPO

/\c. information disclosure requirements increase after the company goes public

/\d. Two choices, A and B, are correct

/\e. The three A-B-C choices are all correct

### BS30 IPO and best efforts v. firm commitment

A company going through an initial public offering (“IPO”) hires an investment banker to assist with the process. The extreme types of contract arrangement between company and investment banker are the “firm commitment” contract and the “best efforts” contract. Which statement most accurately describes these alternatives?

{ANSWER: C ; xlADDRESS: Conceptual!$B$118 }

/\a. With the firm commitment contract an investment banker buys the company shares at a fixed price, resells the shares through the IPO, and the company bears all the risk of adverse price movements

/\b. With the best efforts contract an investment banker receives a negotiated fee, assists the company to sell its shares through the IPO at the best price the company can get, and the investment banker bears all the risk of adverse price movements

/\c. The initial one day average return on an IPO is about 15% to 25% and, irrespective of the contract with the investment banker, the issuing company does not receive that day’s capital gain

/\d. Two choices, A and C, are correct

/\e. The three A-B-C choices are all correct

### BS10 Find false NYSE description

Which of the following descriptions of the New York Stock Exchange is false?

{ANSWER: C ; xlADDRESS: Conceptual!$B$525 }

/\a. securities mostly trade by open outcry (yelling & screaming)

/\b. the NYSE is a profit-making sharholder-owned self-regulatory organization

/\c. daily volume averages $500 billion and about 10,000 securities are listed

/\d. companies must request and pay for their securities to be listed

/\e. it has the largest market capitalization of any stock exchange in the world

### BS11 NYSE characteristics, find one true statement

Which statement about the New York Stock Exchange is true?

{ANSWER: D ; xlADDRESS: Conceptual!$B$624 }

/\a. specialists are government employees whose responsibility is maintaining a fair and orderly market

/\b. Federal anti-monopoly laws require that the NYSE provide trading floor access to anyone wanting to trade stocks

/\c. NYSE has second largest market cap in the USA

/\d. stocks listed on the NYSE represent companies that satisfy stringent exchange requirements and request their stocks be listed

/\e. Superdot is an electronic system handling all NYSE trades

### BS12 NYSE specialist

A specialist at the New York Stock Exchange is

{ANSWER: D ; xlADDRESS: Conceptual!$B$442 }

/\a. an employee of a company, such as Merrill Lynch or Goldman Sachs, that offers expert investment advice to investors about which NYSE stocks to buy

/\b. an employee of the NYSE that operates expert systems software for disseminating information over the newswire

/\c. a trader employed by a listed company that has expert information about specific stocks

/\d. assigned to a post on the exchange floor and is charged to maintain a fair and orderly market in specific stocks

/\e. an employee of the NYSE skilled at cleaning confetti from the trading floor

### BS13 NYSE legal organization

Which statement best describes the legal organizational form of the New York Stock Exchange?

{ANSWER: C ; xlADDRESS: Conceptual!$B$451 }

/\a. the NYSE is a government supported organization whose objective is to provide a fair marketplace for trading stocks

/\b. the NYSE is a non-profit corporation that provides a marketplace for trading stocks and receives government subsidies to cover costs

/\c. the NYSE is a profit making corporation that seeks profit by providing a fair marketplace for trading stocks

/\d. the NYSE is a government sponsored organization that provides a marketplace for trading stocks and charges fees sufficient exclusively to cover costs

/\e. the NYSE is a non-profit corporation that provides a marketplace for trading stocks and charges fees sufficient exclusively to cover costs

### BS18 Which attribute of the nyse is true

Which one statement about the New York Stock Exchange is most accurate?

{ANSWER: B ; xlADDRESS: Conceptual!$B$460 }

/\a. stocks for about 300,000 companies trade on the NYSE

/\b. the NYSE is a profit making corporation

/\c. average daily volume is about $12 million to $17 million

/\d. total market capitalization is about $20 million to $25 million

/\e. small trades execute on the floor through a system of open outcry

### BS38 Describe the three tools of the Fed

The Federal Reserve Board of Directors uses three significant tools to influence market activity. Which of these statements is the most accurate description of one of these Fed tools?

{ANSWER: D ; xlADDRESS: Conceptual!$B$1814 }

/\a. The official government “federal funds rate” is the interest rate charged by Federal Reserve District banks to member public and private banks.

/\b. The reserve requirement on member bank accounts regulates the amount of loans that banks may lend to business and individual borrowers.

/\c. Buying and selling currencies and government securities in the global financial marketplace affects supply and demand conditions for capital.

/\d. Two choices, B and C, are correct

/\e. None of the A-B-C choices are correct

### BS14 NYSE-NASDAQ comparison

Which of the following comparisons about the NYSE and NASDAQ is true?

{ANSWER: A ; xlADDRESS: Conceptual!$B$644 }

/\a. the number of listed companies is greater on NASDAQ than on the NYSE

/\b. trades execute on the NASDAQ by open outcry whereas on the NYSE they execute electronically

/\c. the average daily dollar volume in recent years was greater on the NASDAQ than on the NYSE

/\d. the NASDAQ comprises a physical location whereas the NYSE is only a sophisticated telecommunications network

/\e. the total market capitalization of listed companies is less on the NYSE than on NASDAQ

### BS22 NASDAQ attributes

Choose the most accurate statement about the NASDAQ stock exchange.

{ANSWER: A ; xlADDRESS: Conceptual!$B$469 }

/\a. The NASD (National Association of Securities Dealers) created NASDAQ and every securities dealer in the USA that works with the public must belong to NASD

/\b. NASDAQ is a stock exchange in Washington DC that markets stocks

/\c. NASDAQ lists stocks for between 15,000 and 20,000 companies

/\d. Two choices, A and C, are correct

/\e. The three A-B-C choices are all correct

### BS26 Nasdaq characteristics

Which statement about the NASDAQ market is most accurate?

{ANSWER: A ; xlADDRESS: Conceptual!$B$478 }

/\a. NASDAQ is a market comprised of many market makers for between 3,000 and 5,500 stocks

/\b. All brokers and companies in the U.S.A. working with securities and the public must trade securities on NASDAQ

/\c. NASDAQ is a market with a physical exchange floor where stocks are traded

/\d. Two choices, A and C, are correct

/\e. The three A-B-C choices are all correct

### BS36 Characteristics of the NSX, PCX, PHLX, Pink sheets, and OTCBB

The acquisition of equities in the U.S. financial markets occurs in a very competitive marketplace with many layers and alternative routes for trade execution. Which one of the following choices is a blatantly FALSE description about one of the routes.

{ANSWER: A ; xlADDRESS: Conceptual!$B$1560 }

/\a. The Pacific Stock Exchange (PCX) in San Francisco was founded in 1862 and in 1999 PCX became the first U.S. stock exchange to switch from a for-profit publicly traded company and instead now operates as a member-owned organization.

/\b. The Pink sheets were founded in 1904 in New York and today quote stock prices for companies that do not register with the SEC and are not required to file financial statements with the government.

/\c. The Philadelphia Stock Exchange (PHLX) was founded in 1790 and is the nation’s oldest. The PHLX has a strong market position trading 1,600 equity options, 19 sectors index options, and currency options and futures.

/\d. The National Stock Exchange (NSX) in Chicago is the third largest stock market in the U.S.A. NSX was founded in 1885 as the Cincinnati Stock Exchange.

/\e. The OTC Bulletin Board (OTCBB) began operations in June 1990 to provide transparency in the over-the-counter equities market. The OTCBB provides price quotes for stocks for companies that register and file financial statements with the SEC. Average share price for OTCBB stocks is about ten cents a share.

### BS15 Exchange clearinghouse function

At an organized exchange such as the New York Stock Exchange, Chicago Board of Trade, etc., the clearinghouse corporation …

{ANSWER: A ; xlADDRESS: Conceptual!$B$487 }

/\a. guarantees the financial integrity of every transaction regardless of the trader’s default risk

/\b. guarantees that prices will not move unlawfully

/\c. guarantees that the profit-making exchange will follow federal laws enacted by the Commodity Futures Trade Commission (CFTC) or Securities Exchange Commission (SEC)

/\d. guarantees that every trader makes a profit as long as they follow established trading rules

/\e. guarantees that all traders abide by trading rules established by the Commodity Futures Trade Commission (CFTC) or Securities Exchange Commission (SEC)

### BS9 Define a discount broker

A discount broker …

{ANSWER: A ; xlADDRESS: Conceptual!$B$496 }

/\a. does not make recommendations but simply executes buy and sell orders based solely on customer instructions

/\b. executes buy and sell orders for customers based on company research and recommendations

/\c. does not make recommendations but simply executes buy and sell orders at discounted stock prices

/\d. offers recommendations for buying and selling stock, and executes orders at low commission costs

/\e. offers recommendations for buying and selling stocks, and executes orders at discounted stock prices

### BS25 Discount broker attributes

A discount broker ...

{ANSWER: A ; xlADDRESS: Conceptual!$B$505 }

/\a. does not make recommendations but simply executes orders

/\b. is not a member of the National Association of Stock Dealers (NASD) but instead belongs to the Discount Brokerage Assoc.

/\c. actively trades stocks from its own inventory in order to increase its company profits

/\d. Two choices, A and B, are correct

/\e. The three A-B-C choices are all correct

### BS20 Asset allocation attributes

An important aspect of personal finance and investments concerns asset allocation. Which statement about asset allocation is most accurate?

{ANSWER: A ; xlADDRESS: Conceptual!$B$1337 }

/\a. asset allocation is the divvying of investment funds into broad asset classes

/\b. studies show individual security selection explains more than asset allocation about long run performance

/\c. traditional asset classes include stocks, bonds, cash, options, and futures

/\d. modern asset allocation categories include large cap stocks, small cap stocks, bonds, cash, and mutual funds

/\e. large institutional asset allocation recommendations outperform a robot (fixed) strategy most of the time

### BS32 Asset allocation traditional classes

Which of the following are among the three traditional asset allocation classes?

{ANSWER: D ; xlADDRESS: Conceptual!$B$185 }

/\a. stocks

/\b. bonds

/\c. mutual funds

/\d. Two choices, A and B, are correct

/\e. The three A-B-C choices are all correct

### BS5 What is a mutual fund family

In the mutual fund industry, what is a family?

{ANSWER: A ; xlADDRESS: Conceptual!$B$424 }

/\a. a collection of member funds that are offered by the same sponsoring company

/\b. an association of industry workers whose headquarters is in Boston

/\c. a group of different companies that nonetheless have the same investment objective

/\d. a collection of member funds within one company that have the same investment objective

/\e. a collection of bank holding companies that offer mutual fund investments to its depositors

### BS6 What is a mutual fund objective - sentences

Which statement about mutual fund investment objectives is most accurate?

{ANSWER: A ; xlADDRESS: Conceptual!$B$684 }

/\a. an equity income fund invests in stocks with high dividend yields

/\b. a growth fund invests in companies with growing profit margins

/\c. a sector fund invests in stocks from a narrow geographical sector of the country

/\d. an emerging market fund invests in stocks from international highly developed leading economies

/\e. a balanced fund invests in stocks from a balanced cross-section of the economy

### BS34 Mutual fund objectives - matching game

Here are categories of mutual funds: (1) Growth funds; (2) Value funds; (3) Balanced funds; (4) Index funds; (5) Money market funds; (6) taxable bond funds; (7) tax-exempt funds.

Here are different types of securities that mutual funds own to pursue different objectives:

(T) bonds issued by companies such as ATT or IBM

(U) a wide mix of many types of bonds and equities

(V) short-term credit market securities issued by U.S. corporations and government agencies

(W) equities for companies whose intrinsic value exceed current price

(X) a passive investment style that does not pick winners but simply tracks returns for an underlying basket of stocks

(Y) equities for companies that appear ready to realize large increases in sales and earnings

(Z) bonds issued by enterprises that pursue public objectives and have authority to offer interest income that is not subject to taxes

Find the choice that correctly matches categories with objectives (for example, “2Y” matches category 2 with objective Y).

{ANSWER: C ; xlADDRESS: Conceptual!$B$1317 CLUE: 1Y,2W,3U,4X,5V,6T,7Z }

/\a. 1Y, 4X, 5W, 6T, 7U

/\b. 1V, 2W, 3U, 6X, 7Z

/\c. 2W, 4X, 5V, 6T, 7Z

/\d. 2W, 3U, 4X, 5Z, 6V

/\e. 2Z, 3U, 4Y, 6T, 7W

### BS7 What is a mutual fund’s net asset value

What is an equity mutual fund's net asset value?

{ANSWER: C ; xlADDRESS: Conceptual!$B$693 }

/\a. the shareprice of stocks owned by the fund, multiplied by the number of fund shares issued to mutual fund investors, divided by the number of shares owned by the fund

/\b. the number of shares owned by the fund, multiplied by the mutual fund shareprice, divided by the number of fund shares issued to mutual fund investors

/\c. the total market value of stocks owned by the fund, minus the fund's liabilities, divided by the number of fund shares issued to mutual fund investors

/\d. the mutual fund's gross investment in plant, property, and equipment minus accumulated depreciation

/\e. the mutual fund shareprice multiplied by the number of shares outstanding

### BS8 What is a mutual fund’s balance sheet like

Which one of the following statements about the balance sheet of a mutual fund that advertises itself as a Telecommunications Fund is true?

{ANSWER: A ; xlADDRESS: Conceptual!$B$702 }

/\a. the fund’s primary liability includes shares issued by the fund to investors such as you, me, or institutional investors

/\b. the fund’s primary liability includes cash that it must pay to investors such as you, me, or institutional investors

/\c. the fund’s primary liability includes equities issued by telecommunications companies such as AT&T, Sprint, etc.

/\d. the fund’s primary asset includes cash that it must pay to investors such as you, me, or institutional investors

/\e. the fund’s primary asset includes shares issued by the fund to investors such as you, me, or institutional investors

### BS16 What is a 401k plan

Most U.S. households single largest lifetime source of savings is a 401k plan. The 401k is a …

{ANSWER: E ; xlADDRESS: Conceptual!$B$711 }

/\a. defined benefit plan with significant tax deferral advantages

/\b. defined benefit plan in which the employer promises the employee specific retirement annuity benefits

/\c. a defined benefit plan in which the employee receives matching contributions from the employer, but the employee must pay taxes on the matching contributions

/\d. defined contribution plan in which the employer promises the employee specific retirement annuity benefits

/\e. defined contribution plan with significant tax deferral advantages

### BS24 Pension plan attributes

Which statement most accurately describes pension plans in the USA?

{ANSWER: B ; xlADDRESS: Conceptual!$B$720 }

/\a. The 401k plan is a defined benefit plan that is the most common pension plan in the USA today

/\b. In a 401k plan employee contributions reduce current employee income taxes because contributions are tax-deferrals

/\c. Companies used to offer employees defined contribution plans but, as time goes on, defined benefit plans are becoming more common

/\d. Two choices, A and C, are correct

/\e. The three A-B-C choices are all correct

### BS37 Describe assets and liabilities for the buy-side institutions

Which statement provides the most accurate description of assets and liabilities for buy-side financial institutions?

{ANSWER: A ; xlADDRESS: Conceptual!$B$1664 }

/\a. The bank sector owns more financial assets than any other financial institution.

/\b. One of the product lines for insurance companies that is showing the largest revenue growth is life insurance premiums.

/\c. Mortgages and other loans represent the largest line items on the Liability side of the aggregate balance sheet for the bank sector.

/\d. Two choices, B and C, are correct

/\e. None of the A-B-C choices are correct

### BS17 Describe a venture capitalist

Which statement about a venture capitalist is most accurate?

{ANSWER: C ; xlADDRESS: Conceptual!$B$740 }

/\a. venture financing typically is like a loan with fixed interest payments and repayment of principal

/\b. venture financing typically goes to established large companies with impressive histories

/\c. generally they are extremely involved in managerial decision-making

/\d. usually their plans involve a lifetime commitment to helping the company

/\e. venture financing represents more than half of all money borrowed by US companies

### BS29 Venture capitalist characteristics

Venture capitalists represent a financing source for many businesses in the USA. Select the statement that best describes the typical venture capital investment.

{ANSWER: B ; xlADDRESS: Conceptual!$B$95 }

/\a. the typical length of the commitment is 10 to 20 years

/\b. one of the four most typical means of liquidation is for the venture capitalist to lose most of the investment because of bankruptcy or reorganization

/\c. the venture capitalist makes a loan to the business at interest rates that typically are more favorable than rates offered by banks

/\d. Two choices, A and C, are correct

/\e. None of the A-B-C choices are correct

### BS21 currency trading and exchange rates

Choose the most accurate statement about international currencies and exchange rates.

{ANSWER: C ; xlADDRESS: Conceptual!$B$760 }

/\a. daily currency trading around the world is about the same volume as on the US equity markets

/\b. Japan plus the 11 countries adopting the Euro have bond markets roughly one-half the size of the USA bond market

/\c. adoption of the Euro makes it easier for Europeon businesses to raise capital

/\d. long ago exchange rates floated with market supply and demand forces but since acceptance of the Bretton Woods agreement most exchange rates are set by governments

/\e. Japan plus the 11 countries adopting the Euro have equity markets roughly same size as the USA equity market

### BS33 Currency exchange rate systems: BrettonWoods, floating v fixed

Choose the most accurate statement about international currency exchange rate systems.

{ANSWER: C ; xlADDRESS: Conceptual!$B$244 }

/\a. The Bretton Woods System was an agreement among the world’s nations that allowed for floating exchange rates and was established in 1972

/\b. With a floating exchange rate system one government declares the exchange rate by which its sovereign currency converts into other currencies

/\c. With a floating exchange rate system market supply and demand forces determine the exchange rate by which one currency converts into other currencies

/\d. Two choices, B and C, are correct

/\e. None of the A-B-C choices are correct

### BS35 Currency exchange rate systems: BrettonWoods, inflation/interest & appreciation

Choose the most accurate statement about international currency foreign exchange markets.

{ANSWER: E ; xlADDRESS: Conceptual!$B$1418 }

/\a. The Bretton Woods System was an agreement among the world’s nations that allowed for floating exchange rates and was established in 1972

/\b. Rising inflation within a country causes their sovereign currency to appreciate relative to other currencies in the foreign exchange market

/\c. Rising interest rates within a country causes their sovereign currency to appreciate relative to other currencies in the foreign exchange market

/\d. Two choices, B and C, are correct

/\e. None of the A-B-C choices are correct

### BS27 When was euro introduced (TRUE/FALSE)

True or false? The euro will be introduced into circulation next year and at that time many Europeon currencies such as the deutschmark and French franc will cease to exist.

{ANSWER: B ; xlADDRESS: Conceptual!$B$56 }

/\a. True b. False

### BS28 motivation for euro

Which statement(s) best describe the motivation for introducing the euro:

{ANSWER: B ; xlADDRESS: Conceptual!$B$62 }

/\a. adoption by eleven European nations of uniform price-setting rules

/\b. an increase in commerce

/\c. a partitioning of national markets into smaller and more accessible marketplaces

/\d. Two choices, A and B, are correct

/\e. None of the A-B-C choices are correct

### BS1 What accounting policies are FASB and SEC debating

Responsibility for monitoring accounting policy in the US belongs to two organizations: the Financial Accounting Standards Board (“FASB”), a private professional association; and the Securities Exchange Commission (“SEC”), an arm of the federal government. FASB and the SEC currently are debating significant changes in accounting policies. Which one of the following issues do the most hotly debated policies pertain to?

{ANSWER: A ; xlADDRESS: Conceptual!$B$989 }

/\a. derivative securities as employee compensation

/\b. current cost inflation adjustments

/\c. properly distinguishing between flows and balances

/\d. effect of deferred taxes on net income

/\e. proper application of DuPont analyses

### BS2 FASB and market value accounting

The Financial Accounting Standards Board (FASB) is continuing initiatives to increase disclosure and accounting requirements of publicly traded companies. The ultimate goal is to have companies report fair market values on their balance sheet, and then include the changes in those values in earnings. Which statement aptly describes the initiative?

{ANSWER: B ; xlADDRESS: Conceptual!$B$1004 }

/\a. FASB wants income statements to show only realized cash flows

/\b. FASB wants balance sheets to show all significant balances regardless of whether they are realized or accrued

/\c. FASB wants balance sheets to show only accrued balances

/\d. FASB wants balance sheets to show only realized balances

/\e. FASB wants income statements to show only accrued cash flows

### BS31 common anti-takeover measures

Three common anti-takeover measures often appear during contests for corporate control. Identify the statement that correctly describes the respective measure.

{ANSWER: D ; xlADDRESS: Conceptual!$B$134 }

/\a. Poison pills are provisions approved by shareholders of potential takeover targets that, among other things, enable management to issue large numbers of new stocks to existing target shareholders.

/\b. Golden parachutes are provisions approved by shareholders of potential takeover targets that provide management with lucrative payments in event they are terminated because of a take-over.

/\c. A white-knight strategy occurs when a potential takeover target gives existing management sufficient new stock so that their ownership position as company leaders is unshakeable.

/\d. Two choices, A and B, are correct

/\e. None of the A-B-C choices are correct

### BS19 Which attribute of the cash flow cycle is true.

Which attribute of the cash flow cycle is true?

{ANSWER: A ; xlADDRESS: Conceptual!$B$780 }

/\a. Labor provides services to business and receive wages in a competitive and fluid economy that exactly equal the value of labor's contribution.

/\b. Markets and institutions provide financial resources to business solely for the purpose of getting voting rights in corporate decisions.

/\c. Wealth that business creates flows primarily as profits to employees.

/\d. Businesses typically borrow money from stakeholders such as employees and promise to repay superior wages in the future.

/\e. Businesses borrow money from stakeholders to purchase capital goods, labor, and other productive services from financial markets.

## Part TR Theoretical finance relationships (verbal questions)

### TR24 T/F “Land-rich, cash-poor” and liquidity ratio

Is the following statement True or False? A company that is "land-rich, cash poor" probably has very high liquidity ratios

{ANSWER: B ; xlADDRESS: Conceptual!$B$1349 }

/\a. True b. False

### TR17 T/F, Asset turnover is biggest for what kind of company

True or False: The asset turnover ratio (= *Sales ÷ Total assets*) probably is larger for a grocery store than for an electric utility company.

{ANSWER: A ; xlADDRESS: Conceptual!$B$105 }

/\a. True b. False

### TR42 Characteristics of financial ratio categories

Select the statement below that is most consistent with the classroom and textbook discussion about typical financial ratios.

{ANSWER: B ; xlADDRESS: Conceptual!$B$1830 }

/\a. A company that successfully avoids the "land-rich, cash poor" syndrome probably has relatively low liquidity ratios.

/\b. A company with a lot of excess borrowing capacity probably has relatively low debt ratios.

/\c. The asset turnover ratio (= Sales ÷ Total assets) probably is higher for a nuclear power plant than for a discount grocery store.

/\d. Two choices, A and C, are correct

/\e. The three A-B-C choices are all correct

### TR38 Special cases of relation between ROR and ROE

When both the (i) equity price-to-book ratio and (ii) number of common shares outstanding are constant then a stable relation exists between the accounting measure for return-on-equity (“*ROE”* = *Net income ÷ Stockholders’ equity*) and the market measure of shareholder rate of return (“*RORt*” = (*Pt + dividendt - Pt-1 ) ÷ Pt-1* ). Given that conditions (i) and (ii) hold, what is an accurate description of that stable relation?

{ANSWER: E ; xlADDRESS: Conceptual!$B$1680 }

/\a. When the company never pays dividends then the ROE always equals the ROR.

/\b. When the equity price-to-book ratio is constant at unity (1.0) then the ROR always equals the ROE.

/\c. When the company dividend payout ratio is 100% then the ROR equals the ROE divided by the equity price-to-book ratio.

/\d. Two choices, B and C, are correct

/\e. The three A-B-C choices are all correct

### TR33 T/F Geometric versus arithmetic average ROR ranking

From a series of periodic rates of return there are two procedures for computing the average rate of return per period: the arithmetic average and the geometric average. Is the following statement about these two statistics *TRUE* or *FALSE*: The arithmetic average periodic rate of return always is less than or equal to the geometric average periodic rate of return.

{ANSWER: B ; xlADDRESS: Conceptual!$B$1536 }

/\a. True b. False

### TR1 Rule of 72

Which statement describes the “rule of 72”?

{ANSWER: A ; xlADDRESS: Conceptual!$B$307 }

/\a. The approximate number of years required for a deposit to double equals 72 divided by the percentage interest rate.

/\b. The simple sum of cash flows required for an investment to earn a positive rate of return equals the investment cost times 72.

/\c. The number of months required for a deposit to double equals the decimal interest rate times 72.

/\d. The number of months required for a deposit to double equals the decimal interest rate divided by 72.

/\e. The simple sum of cash flows required for an investment to earn a positive rate of return equals the investment cost divided by 72.

### TR27 Compare EAR and APR wrt bank advertisements

Banks advertise loans so that you’ll borrow money from them and pay them interest. They also advertise deposits so that you’ll open an account with them and they’ll pay you interest. Which statement below most likely describes the relation between the *effective annual rate (“EAR”)* and *annual percentage rate (“APR”)*.

{ANSWER: E ; xlADDRESS: Conceptual!$B$1442 }

/\a. The EAR generally is bigger than the APR.

/\b. When banks advertise for loans they likely quote the APR.

/\c. When banks advertise for deposits they likely quote the EAR.

/\d. Two choices, A and B, are correct

/\e. The three A-B-C choices are all correct

### TR15 explain discount rate, pvifa, and fvifa

What are proper definitions for PVIFA, FVIFA, and the discount rate?

{ANSWER: D ; xlADDRESS: Conceptual!$B$11 }

/\a. the present value interest factor for an annuity, PVIFA(r,N), equals the total accumulation in an account earning the periodic rate r that results from a series of N one-dollar deposits

/\b. the future value interest factor for an annuity, FVIFA(r,N), equals the total accumulation in an account earning the periodic rate r that results from a series of N one-dollar deposits

/\c. the discount rate is the periodic percentage return subtracted from the future cash flow for computing present value

/\d. Two choices, B and C, are correct

/\e. None of the A-B-C choices are correct

### TR32 Short versus long-term loan advantages

What factors are relevant for a household choosing between borrowing with a 15-year versus a 30-year loan (assume that fees, interest rates, and all else are equal).

{ANSWER: C ; xlADDRESS: Conceptual!$B$1524 }

/\a. Total lifetime interest definitely is less with a 15-year loan so therefore it is a better choice.

/\b. When the household expects liquidity problems in the short-run as their careers commence but for the long-run they expect high income growth then borrowing with a 15-year loan may be advantageous.

/\c. When the household expects that in the short-run their uses for money will have low utility but that in the long-run their uses for money will have higher utility then borrowing with a 15-year loan may be advantageous.

/\d. Two choices, B and C, are correct

/\e. None of the A-B-C choices are correct

### TR2 Sensitivity of total interest to doubling of variables

For the simple time value lump-sum relation with monthly compounding find the most accurate statement. For all cases, hold everything constant except the stated variables.

{ANSWER: A ; xlADDRESS: Conceptual!$B$1148 }

/\a. When the interest rate doubles then the total interest more than doubles.

/\b. When the term doubles then the total interest exactly doubles.

/\c. When the beginning wealth doubles then the total interest less than doubles.

/\d. Two choices, A and C, are correct

/\e. The three A-B-C choices are all correct

### TR3 For which stream is the present value the smallest

Suppose two alternative investments promise cash flow streams that possess equal lives. Further, suppose the simple sum of the cash flows for each investment is the same amount. Given a positive interest rate, which investment has the smallest present value?

{ANSWER: E ; xlADDRESS: Conceptual!$B$370 }

/\a. an investment which generates most cash flows at the beginning of its life.

/\b. an investment that is being discounted by a small discount rate.

/\c. there is no reliable relationship between the distribution of cash flows and present value.

/\d. an investment which generates equal cash flows each period.

/\e. an investment which generates most cash flows at the end of its life.

### TR4 For which stream is the present value the biggest

Suppose two alternative investments promise cash flow streams that possess equal lives. Further, suppose the simple sum of the cash flows for each investment is the same amount. Given a positive interest rate, which investment has the biggest present value?

{ANSWER: A ; xlADDRESS: Conceptual!$B$789 }

/\a. an investment which generates most cash flows at the beginning of its life.

/\b. an investment which generates equal cash flows each period.

/\c. an investment that is being discounted by a large discount rate.

/\d. an investment which generates most cash flows at the end of its life.

/\e. there is no reliable relationship between the distribution of cash flows and present value.

### TR5 For which stream is the present value the OR(smallest, biggest)

Suppose two equal-cost alternative investments promise cash flow streams that possess equal lives. Further, suppose the simple sum of the after-tax cash flows for each investment is the same amount. Given a positive interest rate, which investment has the smallest present value?

{ANSWER: D ; xlADDRESS: Conceptual!$B$1020 }

/\a. there is no reliable relationship between the distribution of cash flows and present value.

/\b. an investment that has relatively high sales revenues.

/\c. an investment that is being discounted by a small discount rate.

/\d. an investment which generates most cash flows at the end of its service life.

/\e. an investment which generates equal cash flows each period.

### TR6 Fixed payment loan sensitivity to doubling of variables

Which statement about a monthly fixed payment loan is most accurate? For all cases, hold everything constant except the stated variables.

{ANSWER: E ; xlADDRESS: Conceptual!$B$1159 }

/\a. If the initial loan principal doubles then the loan payment increases by more than 100%.

/\b. If the loan term halves then the loan payment halves.

/\c. If the initial loan principal doubles then the loan payment increases by less than 100%.

/\d. If the interest rate doubles then the loan payment doubles.

/\e. If the initial loan principal doubles then the loan payment doubles.

### TR7 Find true statement about relation between streams and present value

X and Y are two fixed-payment annuities and the only information you have about the annuities is that when one provides a cash flow so does the other. Which statement about these annuities must always be true?

{ANSWER: E ; SETUP: No links ; QUESTION: TR7 }

/\a. If X costs more than Y then the rate of return is less for X than for Y.

/\b. If X costs less than Y then the rate of return is less for X than for Y.

/\c. If the simple sums of cash flows for X and Y are the same, and X costs more than Y, then the rate of return is more for X than for Y.

/\d. If the simple sums of cash flows for X and Y are the same, and X costs more than Y, then the rate of return is less for X than for Y.

/\e. None of the above is necessarily true.

### TR8 Find false statement about relation between streams and present value

X and Y are two fixed-payment annuities and the only information you have about the annuities is that the rate of return for X is larger than for Y. Which statement must always be false?

{ANSWER: E ; SETUP: No links ; QUESTION: TR8}

/\a. If X costs more than Y, the periodic cash flow for X might be more than for Y.

/\b. If X costs less than Y, the periodic cash flow for X might be more than for Y.

/\c. If X has a longer payment stream than Y, the periodic cash flow for X might be less than for Y.

/\d. If X has a shorter payment stream than Y, the periodic cash flow for X might be less than for Y.

/\e. None of the above is necessarily false.

### TR21 Is expensing better than depreciating a capital expenditure?

The company this year has capital expenditures of $35,000 and the financing rate is 6.9%. True or false: If the expenditure is depreciated for tax purposes very rapidly (such as over 3 years or even immediately as with “expensing” like cost-of-goods-sold) then the company is financially better-off than if they had depreciated over a long time period (such as over 10-years).

{ANSWER: A ; xlADDRESS: Conceptual!$B$1246 }

/\a. True b. False

### TR36 Describe NPV

Which statement is most consistent with the *Net present value* (NPV) and *Internal rate of return* concepts?

{ANSWER: E ; xlADDRESS: Conceptual!$B$1632 }

/\a. The NPV for a project is the financing rate at which the project’s IRR is zero.

/\b. The NPV for a project is the amount of wealth that the project creates.

/\c. When a project’s NPV is negative then the actual financing rate is less than the IRR.

/\d. Two choices, A and B, are correct

/\e. None of the A-B-C choices are correct

### TR39 Relation between YTM and actual ex post ROR

Which statement is the best description for a bond investment of the relation between the promised yield-to-maturity and the actual *ex post* rate of return?

{ANSWER: B ; xlADDRESS: Conceptual!$B$1696 }

/\a. The actual ex post ROR is less than the promised yield-to-maturity when you own the bond until maturity and receive all expected cash flows.

/\b. The actual ex post ROR equals the promised yield-to-maturity when you sell a bond before it matures and the YTM at time of sale is the same as when it was purchased.

/\c. The actual ex post ROR exceeds the promised yield-to-maturity when you sell a bond before it matures and the YTM at time of sale exceeds the YTM when it was purchased.

/\d. Two choices, A and B, are correct

/\e. None of the A-B-C choices are correct

### TR34 T/F Moving average trading strategy

A mainstay of technical analysis is comparison of moving averages with different lengths. Is the following statement of the moving average trading strategy *True* or *False*: A buy signal results when the short-run moving average becomes smaller than the long-run moving average.

{ANSWER: B ; xlADDRESS: Conceptual!$B$1544 }

/\a. True b. False

### TR22 Describe partitioning of stock ROR

According to the constant growth dividend valuation model, the total rate of return partitions into the expected dividend yield and the capital gains yield. Which statement is the most accurate description of the partition?

{ANSWER: E ; xlADDRESS: Conceptual!$B$1294 }

/\a. the long-run average dividend yield is bigger than the capital gains yield

/\b. the capital gains yield minus the expected dividend yield equals the total rate of return

/\c. usually the dividend component is an accrued cash flow whereas the capital gains yield is a realized cash flow

/\d. the dividends are usually tax exempt whereas capital gains are immediately taxable

/\e. the dividend yield is more predictable and less risky than the capital gains yield

### TR18 T/F, intrinsic value in dividend growth when g>r

The dividend growth valuation model equates intrinsic value to the discounted sum of the perpetual and smoothly growing dividend stream. When the dividend growth rate *(g)* exceeds the discount rate *(r)* the formula gives an intrinsic value that is a negative number. Determine whether the following interpretation of the preceding fact is TRUE or FALSE: the stock's intrinsic value means the stock is worthless.

{ANSWER: B ; xlADDRESS: Conceptual!$B$168 }

/\a. True b. False

### TR40 Relation between g, r and V in the constant growth model

The dividend growth valuation model equates a stock’s intrinsic value to the discounted sum of the perpetual and smoothly growing dividend stream. The relation between the dividend growth rate *(g)* and the discount rate *(r)* is very important. Which statement accurately describes that relation?

{ANSWER: A ; xlADDRESS: Conceptual!$B$1712 }

/\a. When *g* equals zero percent then the stock’s intrinsic value computes as the *present value* of a perpetuity, div/r.

/\b. When *g* exceeds *r* then the stock’s intrinsic value is negative, meaning the stock is worthless.

/\c. The stock’s intrinsic value is a decreasing function of the dividend growth rate *g.*

/\d. Two choices, A and C, are correct

/\e. The three A-B-C choices are all correct

### TR25 (T/F) Effect of payout policy and company opportunities on intrinsic P/E ratio

Suppose that a company’s stock price equals the discounted sum of its perpetual and smoothly growing dividend stream. The “intrinsic P/E ratio” provides an explanation for the relation between intrinsic value, dividend payout policy, and the magnitude of company investment opportunities (as revealed through its return-on-equity) relative to shareholder discount rate. Within the “intrinsic P/E ratio” framework, is the following statement TRUE or FALSE: the stock price for a company with superior investment opportunities probably increases when the company increases its dividend payout ratio.

{ANSWER: B ; xlADDRESS: Conceptual!$B$1357 }

/\a. True b. False

### TR10 PE ratio and dividend growth dynamics

You observe the following for companies A and B:

price per share: $42.80 for company A, and $26.10 for company B

earnings per share: $1.93 for company A, and $1.43 for company B

In an equilibrium setting where prices are consistent with the dividend growth model, which statement is supported best by the above data?

{ANSWER: A ; xlADDRESS: Conceptual!$B$806 PE\_A = 22.2 ;PE\_B = 18.3}

/\a. company A probably has less risky dividends than company B

/\b. company A probably is overvalued relative to company B

/\c. company A probably is undervalued relative to company B

/\d. company A probably has fewer growth opportunities than company B

/\e. company A probably has riskier dividends than company B

### TR31 T/F Primary market supply and demand

Supply and demand schedules for primary market financial securities relate equilibrium security price with quantity of securities. TRUE or FALSE: The supply schedule for primary market securities is very flat (elastic) and means that a small change in equilibrium price associates with an extreme change in equilibrium quantity.

{ANSWER: A ; xlADDRESS: Conceptual!$B$1512 }

/\a. True b. False

### TR29 Describe the risk premium for these idiosyncratic risk sources

*Liquidity risk* refers to the likelihood that a security easily and quickly converts to cash at the prevailing market value. *Term risk* relates to the timing of cash flows that a security implicitly or explicitly promises. *Default risk* refers to the likelihood that an issuer may be unable to fulfill financial obligations. Which statement accurately describes the *risk premium* relevant to these sources of idiosyncratic risk?

{ANSWER: A ; xlADDRESS: Conceptual!$B$1474 }

/\a. When security liquidity decreases then the liquidity risk premium increases.

/\b. When the timing of expected cash flows tilt toward the near-term then the term risk premium increases.

/\c. When the likelihood of default by the issuer decreases then the default risk premium gets bigger.

/\d. Two choices, A and C, are correct

/\e. The three A-B-C choices are all correct

### TR23 Std.Deviation treatment of upside v downside

The most common statistic for measuring risk is the standard deviation of expected returns. True or False: the standard deviation treats extreme upside returns as being less risky than downside returns because investors perceive upside returns as good opportunities

{ANSWER: B ; xlADDRESS: Conceptual!$B$1306 }

/\a. True b. False

### TR19 Properties of standard deviation

The most common statistic for measuring risk is the standard deviation of expected returns. Which statement best describes the standard deviation as a risk measure?

{ANSWER: D ; xlADDRESS: Conceptual!$B$176 }

/\a. the standard deviation gets larger as the likelihood of extreme outcomes decreases

/\b. the standard deviation is equally sensitive to upside as well as downside extreme returns

/\c. when expected returns have a normal distribution then the 95% confidence interval for next period’s return approximately equals the mean return plus or minus two standard deviations

/\d. Two choices, B and C, are correct

/\e. None of the A-B-C choices are correct

### TR16 Risk characteristics of standard deviation

The standard deviation of returns, σ , is the most common risk measure for securities. Which statement(s) accurately describe this measure?

{ANSWER: B ; xlADDRESS: Conceptual!$B$46 }

/\a. the unit of measurement for σ is “%-squared” and that is identical to the unit of measurement for expected return

/\b. for security returns that are normally distributed about 95% of all outcomes lie within two σ of the expected return

/\c. σ treats extreme upside returns as being less risky than downside returns because investors perceive upside returns as good opportunities

/\d. Two choices, A and C, are correct

/\e. The three A-B-C choices are all correct

### TR30 T/F Sell low risk, buy high risk, reduce total risk

True or False: Selling some of your low-risk security and buying a high-risk security may sometimes increase total portfolio risk (standard deviation).

{ANSWER: A ; xlADDRESS: Conceptual!$B$1495 }

/\a. True b. False

### TR11 Portfolio characteristics

You form a portfolio by combining shares of stocks for two different companies. The companies have different expected returns, and different risks. Which statement is true for all of the possible portfolios that contain shares in both companies? (NOTE: Choices below might be incorrect because they always are false, whereas others might be incorrect because they are sometimes true and sometimes false. Only the correct choice is always true.)?

{ANSWER: A ; xlADDRESS: Conceptual!$B$815 }

/\a. The return for the portfolio is less than the return of the highest return stock.

/\b. The risk for the portfolio is less than the risk of the least risky stock.

/\c. The risk of the portfolio is greater than the risk of the least risky stock.

/\d. The return for the portfolio is less than the return of the lowest return stock.

/\e. The risk for the portfolio lies between the risks of the component stocks.

### TR28 Characteristics of the minimum risk portfolio

The minimum risk portfolio for two securities, call them *X* and *Y*, is easily found given the component security risks (say *σ(X)* and *σ(Y)* ) and the correlation between returns (*ρ*). Which statement accurately describes the minimum risk portfolio?

{ANSWER: A ; xlADDRESS: Conceptual!$B$1458 }

/\a. The allocation in X decreases as the risk of Y decreases.

/\b. The covariance equals ρ times σ(X) times σ(Y) and always the sign of covariance is opposite the sign of ρ.

/\c. When the securities have equal risk then the allocation to X equals the ratio of Y’s variance to the sum of variances.

/\d. Two choices, A and B, are correct

/\e. None of the A-B-C choices are correct

### TR35 T/F For equal risk X and Y find minimum risk portfolio

Suppose that you are interested in two securities, call them *X* and *Y.* You have no idea about their expected returns or correlation. You are confident, however, that their risks are identical. You want to make a portfolio from either or both securities. Your only criterion is to create a portfolio that is not dominated, that is, choose a portfolio in the feasible allocation set. According to modern portfolio theory there is one strategy that definitely works. Is this statement a *True* or *False* description of the strategy: Analyze historical stock returns for X and Y and invest all money in the stock that had the best performance last year.

{ANSWER: B ; xlADDRESS: Conceptual!$B$1572 }

/\a. True b. False

### TR20 T/F Does high risk get high return...

According to the Capital Asset Pricing Model, stocks with large standard deviations of expected returns earn high equilibrium rates of return .

{ANSWER: B ; xlADDRESS: Conceptual!$B$202 }

/\a. True b. False

### TR13 What characteristic defines a security as OR(aggressive, conservative)

Which statement is most consistent with the Capital Asset Pricing Model?

{ANSWER: D ; xlADDRESS: Conceptual!$B$1188 }

/\a. a conservative stock is one whose systematic risk exceeds its unsystematic risk

/\b. an aggressive stock is one whose systematic risk exceeds its unsystematic risk

/\c. a conservative stock is one whose systematic risk exceeds 12%

/\d. an aggressive stock is one whose beta is larger than one

/\e. a conservative stock is one whose beta is greater than one

*TR14 for the eExam.rtf*

|  |  |  |
| --- | --- | --- |
|  | beta | standard deviation |
| stock A | 0.98 | 0.30 |
| stock B | 1.10 | 0.16 |

### TR14 compare systematic and unsystematic risk

Two stocks, A and B, possess the following characteristics.

*beta:* 0.98 *for A and* 1.10 *for B*

*sigma:* 0.30 *for A and* 0.16 *for B*

When idiosyncratic risk is perfectly diversifiable then which statement about the security risk premium is most accurate?

{ANSWER: C ; xlADDRESS: Conceptual!$B$1203 }

/\a. stock A has the highest required risk premium because its total risk is largest

/\b. stock B has the highest required risk premium because it has the most idiosyncratic risk

/\c. stock B has the highest required risk premium because its beta is largest

/\d. stock A has the highest required risk premium because its standard deviation is largest

/\e. stock A has the highest required risk premium becauseit has the least idiosyncratic risk

### TR12 Which CAPM concept is correct

Which statement about important concepts in the Capital Asset Pricing Model is most accurate?

{ANSWER: A ; xlADDRESS: Conceptual!$B$829 }

/\a. the capital market line passes through two points with coordinates (standard deviation, rate of return) equal to (0, risk-free rate) and (market standard deviation, expected market return)

/\b. the efficient frontier passes through two points with coordinates (standard deviation, rate of return) equal to (0, risk-free rate) and (market standard deviation, expected market return)

/\c. the efficient frontier passes through two points with coordinates (beta, rate of return) equal to (0, risk-free rate) and (1, expected market return)

/\d. the capital market line passes through two points with coordinates (beta, rate of return) equal to (0, risk-free rate) and (1, expected market return)

/\e. the security market line is the risk-return profile that contains the set of all dominant portfolios comprised possibly of all securities

### TR9 (T/F): Rho measures proportion of total risk that merits compensation

The *Capital asset pricing model* describes the special case when all idiosyncratic risk within a well-diversified “market portfolio” distributes like white noise and vanishes. For this special case the required rate of return for security *X* equilibrates to the risk free rate plus compensation for the systematic risk that security *X* embodies. Is this statement about the correlation coefficient *ρ* between secuity *X* and the market portfolio TRUE or FALSE: 1 - ρ represents the proportion of security X risk σx that vanishes and does not merit compensation.

{ANSWER: A ; xlADDRESS: Conceptual!$B$1802 }

/\a. True b. False

### TR26 (T/F) Call option portfolio insurance and dominance wrt pure-stock

There are two strategies that you might pursue. Strategy 1 is an insurance strategy that allocates 5% of the portfolio in call options with strike of 40 and the remainder of the portfolio in money market securities. Strategy 2 is a pure-stock strategy that allocates 100% of the portfolio in company stock that today has a price of $37.20 . You compute outcomes for all possible scenarios. You computations correctly show that (1) for extreme upside stock price movements then the insurance strategy outperforms the pure-stock strategy; (2) for extreme downside stock price movements then the insurance strategy outperforms the pure-stock strategy. Does your interpretation of all outcomes suggest that this conclusion is True or False?

The insurance strategy outperforms the pure-stock strategy for extreme stock price movements up and down, so because the insurance strategy always results in better outcomes the insurance strategy dominates the pure-stock strategy.

{ANSWER: B ; xlADDRESS: Conceptual!$B$1406 }

/\a. True b. False

### TR41 Find effects of shocks in loanable funds theory of interest

The *loanable funds theory of interest* is useful for explaining the level of the risk-free interest rate. That model allows insights about effects of exogenous shocks upon movement in the risk-free rate. Find the statement that is most consistent with the loanable funds theory of interest.

{ANSWER: A ; xlADDRESS: Conceptual!$B$1732 }

/\a. When an economic contraction causes a reduction in the availability of private credit market securities then, ceteris paribus, the equilibrium risk-free rate declines.

/\b. When private companies increase their demand for loanable funds then, ceteris paribus, the equilibrium risk-free rate declines.

/\c. When political and economic world events trigger a flight to high quality securities then, ceteris paribus, the equilibrium risk-free rate increases.

/\d. When a major foreign world economy decides to sell-off their huge holdings of U.S. Treasury securities then, ceteris paribus, the equilibrium price for risk-free securities increases.

/\e. When tax revenues are less than government expenditures and the Treasury issues new securities then, ceteris paribus, the equilibrium risk-free rate declines.

### TR37 Purchasing power parity and inflation

The *Relative Purchasing Power Parity* formula relates next year’s spot price for one unit of foreign currency to the inflation rates in the foreign and domestic economies. Choose the statement that best describes that relation.

{ANSWER: A ; xlADDRESS: Conceptual!$B$1648 }

/\a. Next year’s spot price for a unit of foreign currency increases as the inflation rate in the foreign economy decreases.

/\b. Next year’s spot price for a unit of foreign currency decreases as the inflation rate in the domestic economy increases.

/\c. When the inflation rate in the domestic and foreign economies are equal then probably the domestic currency depreciates relative to the foreign currency.

/\d. Two choices, A and C, are correct

/\e. None of the A-B-C choices are correct

## Part MB Market behavior and measures (verbal questions)

### MB1 Historical risk & return of major asset classes

Which of the following statements about historical security-market performance in the U.S.A. is most accurate?

{ANSWER: A ; xlADDRESS: Conceptual!$B$1035 }

/\a. the annual average rate of return over the past 70 years has been higher for large company stocks than for corporate bonds

/\b. the annual average rate of return over the past 70 years has been higher for long-term government securities than for large company stocks

/\c. the annual average rate of return over the past 70 years has been higher for T-bills than for small company stocks

/\d. the annual average rate of return over the past 70 years has been higher for T-bills than for large company stocks

/\e. the annual average rate of return over the past 10 years has been higher for corporate bonds than for large company stocks

### MB2 What are these money rates

Which of the following statements about money rates is most accurate?

{ANSWER: B ; xlADDRESS: Conceptual!$B$865 }

/\a. the prime rate is the rate applicable to low-risk mortgages

/\b. the Treasury bill rate is a rate on short-term U.S. government bills, sold at discount

/\c. the Certificate of Deposit rate is the amount that banks and credit unions pay to customer savings accounts

/\d. the discount rate measures the rate that the U.S. Treasury charges the Federal Reserve Board for loans

/\e. the discount rate measures the amount by which the interest rate at Credit Unions exceeds the rate at Federal Reserve banks

### MB3 Which of these money rates has the largest premium

Which statement about interest rates is most likely true?

{ANSWER: A ; xlADDRESS: Conceptual!$B$885 }

/\a. the interest rate probably is greater on CCC corporate bonds than on AAA corporate bonds

/\b. the interest rate probably is greater on high quality investment grade bonds than on junk bonds

/\c. the interest rate normally is greater on short-term corporate bonds than on long-term corporate bonds

/\d. the interest rate probably is greater on tax-exempt AAA municipal bonds than on taxable AAA corporate bonds

/\e. corporations seeking sales growth by expanding overseas often issue bonds that pay the tax exempt interest rate

### MB18 Money rates (discount, prime, Tbill)

Which statement about money rates in the USA is most accurate?

{ANSWER: B ; xlADDRESS: Conceptual!$B$30 }

/\a. the discount rate equals the interest rate that Federal Reserve District Banks charge the U.S. Treasury for government debt

/\b. the prime rate is the interest rate that the largest banks charge the best corporate customers

/\c. the Treasury bill rate is the implied interest rate paid by the U.S. government on 30-year loans

/\d. Two choices, B and C, are correct

/\e. None of the A-B-C choices are correct

### MB19 Yield curve characteristics

Which characteristic best describes the Treasury yield curve?

{ANSWER: B ; xlADDRESS: Conceptual!$B$159 }

/\a. the curve normally begins flat and steepens downward toward the right

/\b. the curve normally begins with a steep upward slope that flattens toward the right

/\c. the curve depicts the spread between corporate bond yields and Treasury bonds

/\d. coordinates of the yield curve are interest rate on horizontal axis and term-to-maturity on vertical axis

/\e. coordinates of the yield curve are yield-to-maturity on horizontal axis and term-to-maturity on vertical axis

### MB10 Normal yield curve

Which of the following best describes a graph of the normal yield curve?

{ANSWER: E ; xlADDRESS: Conceptual!$B$894 }

/\a. price on vertical axis, time to maturity on horizontal axis, and a line that curves toward $1000

/\b. price on vertical axis, coupon rate on horizontal axis, and slope equal to yield-to-maturity

/\c. yield-to-maturity on horizontal axis, price on vertical axis, and a line that curves toward $1000

/\d. yield-to-maturity on vertical axis, term on horizontal axis, and a negative slope

/\e. yield-to-maturity on vertical axis, term on horizontal axis, and a positive slope

### MB24 T/F Bond v. Stock market size

The largest financial markets in the U.S.A. include the bond market and the stock market. One of these markets, however, is significantly larger than the other market. Decide whether this statement is true or false: On an average day the dollar trading volume of all bonds traded in the U.S.A. is significantly less than the dollar trading volume of all stocks in the U.S.A.

{ANSWER: B ; xlADDRESS: Conceptual!$B$1760 }

/\a. True b. False

### MB7 Bond price to coupon rate relation

Which statement about bond prices is most accurate?

{ANSWER: D ; xlADDRESS: Conceptual!$B$914 }

/\a. For a premium bond the yield-to-maturity exeeds the coupon rate

/\b. With an interest rate increase the price rises more for long-term bonds than for short-term bonds

/\c. With an interest rate decline the price rises more for short-term bonds than for long-term bonds

/\d. When a bond is sold at an interest rate less than the initial yield to maturity then the actual rate of return exceeds the promised yield

/\e. For a discount bond the coupon rate exceeds the yield to maturity

### MB8 Bond ratings

Which of the following statements about bond ratings is false?

{ANSWER: A ; xlADDRESS: Conceptual!$B$934 }

/\a. the interest rate that an issuer must pay is higher for an A-rated than for a C-rated bond

/\b. a C-rated bond has more default risk than an A-rated bond

/\c. a rating change from C to B implies the spread between the bond and Treasuries probably will narrow

/\d. a rating change from C to B implies more institutions will be allowed to own the bond

/\e. publicly traded bond prices hardly move when a rating change is announced

### MB9 Bond returns

Bond mutual funds several years ago had an annual rate of return of -23%. Which statement describes the likely cause of the performance?

{ANSWER: E ; xlADDRESS: Conceptual!$B$950 }

/\a. Coupon rates probably were relatively high all year long

/\b. The stock market probably lost substantially and bond funds attracted money, thereby driving bond prices

/\c. Interest rates probably fell dramatically that year

/\d. Coupon rates probably were relatively low all year long

/\e. Interest rates probably rose dramatically that year

### MB4 Earnings and shareprice reaction

Xerox reported this morning that their earnings per share (“eps”) for the most recent quarter is -$2.10; this represents a loss. Which statement about the probable shareprice reaction is most accurate?

{ANSWER: A ; xlADDRESS: Conceptual!$B$1062 }

/\a. The shareprice probably rises if eps that analysts expected was $-2.53

/\b. The shareprice probably rises if eps that analysts expected was $-1.91

/\c. The shareprice probably falls if eps that analysts expected was $-2.28

/\d. The shareprice probably rises if the eps that analysts expected was $-1.61

/\e. The shareprice probably falls if the eps that analysts expected was $-2.32

### MB5 DJIA definition

What does the Dow Jones Industrial Average (DJIA) represent?

{ANSWER: D ; xlADDRESS: Conceptual!$B$959 }

/\a. The sum of stock prices for the 100 stocks in the Dow Jones Industrial, Transportation, and Financial indexes.

/\b. The sum of 30 stock prices divided by 30.

/\c. The sum of stock prices for the 100 stocks in the Dow Jones Industrial index.

/\d. The sum of 30 stock prices divided by a divisor that diminishes whenever a component stock splits.

/\e. The geometric average of the 500 stock prices for the S&P 500 companies.

### MB21 Find DJIA given average price and divisor

Suppose that today the Dow Jones Industrial Average (DJIA) of 30 stocks has a divisor equal to 0.28. You are aware that today’s average price for the 30 stocks is $48.40 . What does today’s DJIA equal?

{ANSWER: B ; xlADDRESS: Conceptual!$B$1274 }

/\a. 4,714 b. 5,186 c. 4,286 d. 3,896 e. 3,542

### MB6 DJIA in motion

Suppose that today the Dow Jones Industrial Average (DJIA) of 30 stocks has a divisor equal to 0.24. If there is a 450 point decrease in the DJIA, what is the change in the average shareprice of the DJIA stocks?

{ANSWER: E ; xlADDRESS: Conceptual!$B$1173 }

/\a. the average shareprice decreases by $4.76

/\b. the average shareprice increases by $4.76

/\c. the average shareprice increases by $3.60

/\d. the average shareprice increases by $4.14

/\e. the average shareprice decreases by $3.60

### MB23 Find new DJIA given a stock split

The Dow Jones Industrial Average (“DJIA”) equals the sum of 30 company stock prices divided by a *divisor*. Yesterday the DJIA closed at 9,260 and the sum of the 30 stock prices was 1,056. This morning one of the companies, call it Company X, announced a 2-for-1 stock split effective instantaneously. The market closed today and the sum of the 30 stock prices was $951 and that includes the post-split price for Company X which is $62 . Find the DJIA at today’s market closing.

{ANSWER: E ; xlADDRESS: Conceptual!$B$1585; CLUES: divisor = 0.11404; sum w/o company X = $889 ; sum w/ company X adjusted shares = $1,013 }

/\a. 8,129 b. 8,373 c. 8,624 d. 9,149 e. 8,883

### MB25a Find new index for DJ2-stock index given split

There is a new stock index that operates just like the Dow Jones Industrial Average. This new index is called the called the DJA&Z. An any moment in time the DJA&Z equals sum of stock prices for companies Alpha and Zed divided by the divisor. Today the divisior is 2 and the stock price is $119 for Alpha and $120 for Zed. Hence, today the DJA&Z equals 119.5. Tomorrow the stock price for Alpha closes the day at $116 . Also tomorrow the management of company Zed announces an immediate 4-for-2 stock split that is effective instantaneously. Tomorrow the post-split stock price for Zed closes daily trading at $66 per share. Find the DJA&Z at the close of trading tomorrow.

{ANSWER: C ; xlADDRESS: Conceptual!$B$1774 CLUES: split-adjusted priceZ = $132 }

/\a. 136.4 b. 150.0 c. 124.0 d. 112.7 e. 165.0

### MB25b Find new divisor for DJ2-stock index given split

There is a new stock index that operates just like the Dow Jones Industrial Average. This new index is called the called the DJA&Z. An any moment in time the DJA&Z equals sum of stock prices for companies Alpha and Zed divided by the divisor. Today the divisior is 2 and the stock price is $119 for Alpha and $120 for Zed. Hence, today the DJA&Z equals 119.5. Tomorrow the stock price for Alpha closes the day at $116 . Also tomorrow the management of company Zed announces an immediate 4-for-2 stock split that is effective instantaneously. Tomorrow the post-split stock price for Zed closes daily trading at $66 per share. Find the new divisor for the DJA&Z at the close of trading tomorrow.

{ANSWER: B ; xlADDRESS: Conceptual!$F$1774 CLUES: split-adjusted priceZ = $132 }

/\a. 1.33 b. 1.47 c. 1.61 d. 1.78 e. 1.21

### MB25c Find new index&divisor for DJ2-stock index given split

There is a new stock index that operates just like the Dow Jones Industrial Average. This new index is called the called the DJA&Z. An any moment in time the DJA&Z equals sum of stock prices for companies Alpha and Zed divided by the divisor. Today the divisior is 2 and the stock price is $119 for Alpha and $120 for Zed. Hence, today the DJA&Z equals 119.5. Tomorrow the stock price for Alpha closes the day at $116 . Also tomorrow the management of company Zed announces an immediate 4-for-2 stock split that is effective instantaneously. Tomorrow the post-split stock price for Zed closes daily trading at $66 per share. Choose the most accurate for the DJA&Z at the close of trading tomorrow.

{ANSWER: E ; xlADDRESS: Conceptual!$J$1774 CLUES: split-adjusted priceZ = $132 }

/\a. The DJ&Z equals 142.6 and the new divisor is 1.28

/\b. The DJ&Z equals 142.6 and the new divisor is 1.47

/\c. The DJ&Z equals 164.0 and the new divisor is 1.28

/\d. The DJ&Z equals 164.0 and the new divisor is 1.47

/\e. The DJ&Z equals 124.0 and the new divisor is 1.47

### MB11 Equity trading behavior

Studies indicate that individual investors who frenetically trade stocks in order to beat a market index, like the SP500, …

{ANSWER: E ; xlADDRESS: Conceptual!$B$974 }

/\a. must invest in small capitalization stocks with high dividend yields

/\b. must invest in the stocks in the index but overweight purchases in stocks with high dividend growth rates

/\c. must pick a small capitalization stock and hold it for several years

/\d. must pick a winning small capitalization stock that quadruples in price

/\e. must earn 2 to 4 points more than the index in order to pay trading costs

### MB17 Long futures vs. long options characteristics

Which one of the following statements best describes the primary difference between a long option position versus a long futures position?

{ANSWER: D ; xlADDRESS: Conceptual!$B$1071 }

/\a. the options position requires collateral whereas the futures position does not

/\b. the futures position is a right to take action whereas the options position is an obligation

/\c. the options position is free to enter whereas the futures position is costly

/\d. the options position is a right to take action whereas the futures position is an obligation

/\e. the options position allows cash settlement whereas the futures position does not

### MB22 Match futures and options characteristics

Futures and options are financial securities that help businesses manage risk. Find below a list of four characteristics (W, X, Y, and Z) that describe these securities. For each characteristic is a blank into which “futures” or “options” correctly fits.

W: \_\_\_\_ are free but you must deposit collateral to validate the security

X: For one underlying asset there exists two different types of \_\_\_\_ and each of those two has one long and one short position

Y: A short \_\_\_\_ position entails an obligation only when the long side chooses to exercise the contract

Z: A long \_\_\_\_ position entails an obligation, not a right, to either exercise or cash out of the contract

Choose the statement that correctly matches all characteristics for that type of security.

{ANSWER: D ; xlADDRESS: Conceptual!$B$1390 }

/\a. These characteristics, ( W X ), are all that pertain to futures

/\b. These characteristics, ( W Z ), are all that pertain to options

/\c. These characteristics, ( Y Z ), are all that pertain to futures

/\d. These characteristics, ( W Z ), are all that pertain to futures

/\e. These characteristics, ( Y Z ), are all that pertain to options

### MB20 Hedging v. speculating in futures and options markets

Two motives drive trading of commodity contracts in the futures and options markets: hedging and speculating. Choose the statement that best describes characteristics of hedgers.

{ANSWER: B ; xlADDRESS: Conceptual!$B$228 }

/\a. the type of commodity covered by the contract is almost irrelevant

/\b. movements in the commodity price have modest effect on the overall outcome

/\c. the outcome depends exclusively on whether the futures contract makes a profit or a loss

/\d. Two choices, A and B, are correct

/\e. None of the A-B-C choices are correct

### MB16 Derivatives trading behavior

Two types of trading behavior most often observed in the derivatives markets includes…

{ANSWER: A ; xlADDRESS: Conceptual!$B$1080 }

/\a. speculating and hedging

/\b. hedging and naked writing

/\c. speculating and short sales

/\d. naked writing and short sales

/\e. limit orders and market orders

### MB15 Index arbitrage strategy

Which statement describes an index arbitrage strategy for the SP500?

{ANSWER: E ; xlADDRESS: Conceptual!$B$1095 }

/\a. buying or selling key stocks in the SP500 index

/\b. taking long or short positions on either SP500 options or futures contracts

/\c. taking a short position on SP500 stocks and a short position on SP500 futures contracts in order to capitalize on fleeting price discrepancies

/\d. taking a long position on SP500 stocks and a long position on SP500 futures contracts in order to capitalize on fleeting price discrepancies

/\e. taking a long position on SP500 stocks and a short position on SP500 futures contracts in order to capitalize on fleeting price discrepancies

### MB14 Program trade definition

A program trade on the New York Stock Exchange is …

{ANSWER: A ; xlADDRESS: Conceptual!$B$1104 }

/\a. simultaneous execution of buy or sell orders for more than a dozen securities, generally ordered by a computer program without human intervention

/\b. one step in a lengthy program designed to exercise in-the-money call options

/\c. one step in a lengthy program designed to exercise in-the-money put options

/\d. simultaneous execution of buy or sell orders for more than a dozen securities, generally ordered by a NYSE market specialist

/\e. simultaneous execution of buy or sell orders by the NYSE Superdot system

### MB26 Why has program trading as a proportion of total trading increased

A program trade on the New York Stock Exchange is the simultaneous execution of buy or sell orders for at least 15 different securities totaling more than $1 million. Class discussion explains that there have been three primary reasons for the explosive growth during recent years in the proportion of total NYSE trades that results from program trading. Choose the statement that is most consistent with the explanation.

{ANSWER: B ; xlADDRESS: Conceptual!$B$1772 }

/\a. Households with increased access to computerized trading have been able to easily execute large trades for larger numbers of stocks.

/\b. During recent decades the management of equity portfolios has become increasingly concentrated into financial institutions, such as pension or mutual funds, and trading behavior has become more sophisticated.

/\c. The Penny Stock Reform Act during the 1990s commanded the Securities Exchange Commission to increase the transparency of program trading.

/\d. Two choices, A and C, are correct

/\e. The three A-B-C choices are all correct

### MB12 Short-interest ratio

The stock market’s short interest ratio equals the number of days it would take, given average daily volume, for all short traders to cover open short positions. Which one of the following is a consistent interpretation of a record high short interest ratio?

{ANSWER: D ; xlADDRESS: Conceptual!$B$1119 }

/\a. It is a bearish signal because it means the Fed probably will be lowering rates

/\b. It is a bullish signal because it means many think the market is headed down

/\c. It can be either a bearish or bullish signal but typically is followed by rising stock prices

/\d. It is a bullish signal because it means buying demand will be high

/\e. It is a bearish signal because it means the Fed probably will be raising rates

### MB13 Short-sale definition

What is a short sale at the New York Stock Exchange?

{ANSWER: A ; xlADDRESS: Conceptual!$B$1128 }

/\a. selling a share at the current price with the obligation to buy it back later at the later price

/\b. selling a share at the current price with the right to buy it back later at a lower price

/\c. buying a share at the current price with the expectation to sell it later for a higher price

/\d. buying a share at the current price with the expectation to sell it later for a lower price

/\e. selling a share at the current price with the right to buy it back later at a higher price

## Part MS Miscellaneous verbal questions

### MS1 Warren Buffet focus on cash flow

According to the article discussed in lecture, when Warren Buffet analyzes a company to buy, such as when he bought $2 billion of American Express shares, which financial variable was most important to him?

{ANSWER: E ; xlADDRESS: Conceptual!$B$1137 }

/\a. equity price-to-book ratio

/\b. net profit margin

/\c. asset turnover ratio

/\d. net working capital

/\e. operating cash flow

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