

Chapter 02

Asset Classes and Financial Instruments

Multiple Choice Questions

1. Which of the following is not a money market instrument?
 - A. Treasury bill
 - B. Commercial paper
 - C. Preferred stock
 - D. Banker's acceptance

2. Thirteen week T-bill auctions are conducted _____.
 - A. daily
 - B. weekly
 - C. monthly
 - D. quarterly

3. When computing the bank discount yield you would use _____ days in the year.
 - A. 260
 - B. 360
 - C. 365
 - D. 366

4. A dollar denominated deposit at a London bank is called _____.
 - A. eurodollars
 - B. LIBOR
 - C. fed funds
 - D. banker's acceptance

5. Money market securities are sometimes referred to as "cash equivalent" because _____.
 - A. they are safe and marketable
 - B. they are not liquid
 - C. they are high risk
 - D. they are low denomination

6. The most actively traded money market security is

- A. Treasury bills
- B. Bankers' Acceptances
- C. Certificates of Deposit
- D. Common stock

7. _____ voting of common stock gives minority shareholders the most representation on the board of directors.

- A. Majority
- B. Cumulative
- C. Rights
- D. Proxy

8. An investor in a T-bill earns interest by _____.

- A. receiving interest payments every 90 days
- B. receiving dividend payments every 30 days
- C. converting the T-bill at maturity into a higher valued T-note
- D. buying the bill at a discount from the face value received at maturity

9. _____ would not be included in the EAFE index.

- A. Australia
- B. Canada
- C. France
- D. Japan

10. _____ is considered to be an emerging market country.

- A. France
- B. Norway
- C. Brazil
- D. Canada

11. Which one of the following is a true statement?

- A. Dividends on preferred stocks are tax-deductible to individual investors but not to corporate investors
- B. Common dividends cannot be paid if preferred dividends are in arrears on cumulative preferred stock
- C. Preferred stockholders have voting power
- D. Investors can sue managers for nonpayment of preferred dividends

12. The bid price of a treasury bill is _____.

- A. the price at which the dealer in treasury bills is willing to sell the bill
- B. the price at which the dealer in treasury bills is willing to buy the bill
- C. greater than the ask price of the treasury bill expressed in dollar terms
- D. the price at which the investor can buy the treasury bill

13. The German stock market is measured by which market index?

- A. FTSE
- B. Dow Jones 30
- C. DAX
- D. Nikkei

14. Deposits of commercial banks at the Federal Reserve are called _____.

- A. bankers acceptances
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- C. repurchase agreements
- D. time deposits

15. Which of the following is not a true statement regarding municipal bonds?

- A. A municipal bond is a debt obligation issued by state or local governments.
- B. A municipal bond is a debt obligation issued by the Federal Government.
- C. The interest income from a municipal bond is exempt from federal income taxation.
- D. The interest income from a municipal bond is exempt from state and local taxation in the issuing state.

16. Which of the following is not a characteristic of a money market instrument?

- A. Liquidity
- B. Marketability
- C. Low risk
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17. An individual who goes short in a futures position

- A. commits to delivering the underlying commodity at contract maturity
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18. Which of the following is not a nickname for an agency associated with the mortgage markets?

- A. Fannie Mae
- B. Freddie Mac
- C. Sallie Mae
- D. Ginnie Mae

19. Commercial paper is a short-term security issued by _____ to raise funds.

- A. the Federal Reserve
- B. commercial banks
- C. large well-known companies
- D. the New York Stock Exchange

20. The maximum maturity on commercial paper is

- A. 270 days
- B. 180 days
- C. 90 days
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21. Which one of the following is a true statement regarding the Dow Jones Industrial Average?

- A. It is a value-weighted average of 30 large industrial stocks
- B. It is a price-weighted average of 30 large industrial stocks
- C. It is a price-weighted average of 100 large stocks traded on the New York Stock Exchange
- D. It is a value-weighted average of all stocks traded on the New York Stock Exchange

22. Treasury bills are financial instruments issued by _____ to raise funds.

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- B. the Federal Government
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- I. T-bills typically sell in denominations of \$10,000
 - II. Income earned on T-bills is exempt from all Federal taxes
 - III. Income earned on T-bills is exempt from state and local taxes
- A. I only
 - B. I and II only
 - C. I and III only
 - D. I, II and III

24. A bond that has no collateral is called _____.

- A. a callable bond
- B. a debenture
- C. a junk bond
- D. a mortgage

25. A _____ gives its holder the right to sell an asset for a specified exercise price on or before a specified expiration date.

- A. call option
- B. futures contract
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26. A T-bill quote sheet has 90 day T-bill quotes with a 4.92 bid and a 4.86 ask. If the bill has a \$10,000 face value an investor could buy this bill for

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27. Which one of the following is a true statement regarding corporate bonds?

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- B. A corporate debenture is a secured bond
- C. A corporate convertible bond gives its holder the right to exchange it for a specified number of the company's common shares
- D. Holders of corporate bonds have voting rights in the company

28. The yield on tax-exempt bonds is _____.

- A. usually less than 50% of the yield on taxable bonds
- B. normally about 90% of the yield on taxable bonds
- C. greater than the yield on taxable bonds
- D. less than the yield on taxable bonds

29. _____ is not a money market instrument.

- A. A certificate of deposit
- B. A treasury bill
- C. A treasury bond
- D. Commercial paper

30. An investor buys a T-bill at a bank discount quote of 4.80 with 150 days to maturity. The investor's actual annual rate of return on this investment was _____.

- A. 4.80%
- B. 4.97%
- C. 5.47%
- D. 5.74%

31. The U.K. stock index is the _____.

- A. DAX
- B. FTSE
- C. GSE
- D. TSE

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33. Which one of the following provides the best example of securitization?

- A. convertible bond
- B. call option
- C. mortgage pass-through security
- D. preferred stock

34. Which of the following indices are market-value weighted?

- I. The NYSE Composite
 - II. The S&P 500
 - III. The Wilshire 5000
- A. I and II only
 - B. II and III only
 - C. I and III only
 - D. I, II and III

35. The interest rate charged by large banks in London to lend money among themselves is called _____.

- A. the prime rate
- B. the discount rate
- C. the federal funds rate
- D. LIBOR

36. A firm that has large securities holdings that wishes to raise money for a short length of time may be able to find the cheapest financing from which of the following?

- A. Reverse repurchase agreement
- B. Banker's acceptance
- C. Commercial paper
- D. Repurchase agreement

37. Currently the Dow Jones Industrial Average is computed by _____.

- A. adding the prices of 30 large "blue-chip" stocks and dividing by 30
- B. calculating the total market value of the 30 firms in the index and dividing by 30
- C. measuring the current total market value of the 30 stocks in the index relative to the total value on the previous day
- D. adding the prices of 30 large "blue-chip" stocks and dividing by a divisor adjusted for stock splits and large stock dividends

38. An investor purchases one municipal and one corporate bond that pay rates of return of 5.00% and 6.40% respectively. If the investor is in the 15% tax bracket, his after tax rates of return on the municipal and corporate bonds would be respectively

- A. 5.00% and 6.40%
- B. 5.00% and 5.44%
- C. 4.25% and 6.40%
- D. 5.75% and 5.44%

39. If a treasury note has a bid price of \$996.25, the quoted bid price in the Wall Street Journal would be _____.

- A. 99:25
- B. 99:63
- C. 99:20
- D. 99:08

40. TIPS are _____.

- A. Treasury bonds that pay a variable rate of interest
- B. U.K. bonds that protect investors from default risk
- C. securities that trade on the Toronto stock index
- D. Treasury bonds that protect investors from inflation

41. The price quotations of treasury bonds in the Wall Street Journal show a bid price of 102:12 and an ask price of 102:14. If you sold the bond you expect to receive _____.

- A. \$1,024.75
- B. \$1,024.38
- C. \$1,023.75
- D. \$1,022.50

42. The Dow Jones Industrial Average is _____.

- A. a price weighted average
- B. a value weight and average
- C. an equally weighted average
- D. an unweighted average

43. Investors will earn higher rates of returns on TIPS than equivalent default risk standard bonds if _____.

- A. inflation is lower than anticipated over the investment period
- B. inflation is higher than anticipated over the investment period
- C. the U.S. dollar increases in value against the euro
- D. the spread between commercial paper and Treasury securities remains low

44. Preferred stock is like long-term debt in that _____.

- A. it gives the holder voting power regarding the firm's management
- B. it promises to pay to its holder a fixed stream of income each year
- C. the preferred dividend is a tax-deductible expense for the firm
- D. in the event of bankruptcy preferred stock has equal status with debt

45. Which of the following does not approximate the performance of a buy and hold portfolio strategy?

- A. An equally weighted index
- B. A price weighted index
- C. A value weighted index
- D. Weights are not a factor in this situation

46. In calculating the Dow Jones Industrial Average, the adjustment for a stock split occurs _____.

- A. automatically
- B. by adjusting the divisor
- C. by adjusting the numerator
- D. by adjusting the market value weights

47. If the market prices of the 30 stocks in the Dow Jones Industrial Average all change by the same dollar amount on a given day, assuming there are no stock splits which stock will have the greatest impact on the average?

- A. The one with the highest price
- B. The one with the lowest price
- C. All 30 stocks will have the same impact
- D. The answer cannot be determined by the information given

48. A bond issued by the State of Alabama is priced to yield 6.25%. If you are in the 28% tax bracket this bond would provide you with an equivalent taxable yield of _____.

- A. 4.50%
- B. 7.25%
- C. 8.68%
- D. none of the above

49. The purchase of a futures contract gives the buyer _____.

- A. the right to buy an item at a specified price
- B. the right to sell an item at a specified price
- C. the obligation to buy an item at a specified price
- D. the obligation to sell an item at a specified price

50. Ownership of a put option entitles the owner to the _____ to _____ a specific stock, on or before a specific date, at a specific price.

- A. right, buy
- B. right, sell
- C. obligation, buy
- D. obligation, sell

51. An investor in a 28% tax bracket is trying to decide whether to invest in a municipal bond or a corporate bond. She looks up municipal bond yields (r_m) but wishes to calculate the taxable equivalent yield r . The formula she should use is given by _____.

- A. $r = r_m * (1 - 28\%)$
- B. $r = r_m / (1 - 72\%)$
- C. $r = r_m * (1 - 72\%)$
- D. $r = r_m / (1 - 28\%)$

52. June call and put options on King Books Inc are available with exercise prices of \$30, \$35 and \$40. Among the different exercise prices, the call option with the _____ exercise price and the put option with the _____ exercise price will have the greatest value.

- A. \$40; \$30
- B. \$30; \$40
- C. \$35; \$35
- D. \$40; \$40

53. Ownership of a call option entitles the owner to the _____ to _____ a specific stock, on or before a specific date, at a specific price.

- A. right, buy
- B. right, sell
- C. obligation, buy
- D. obligation, sell

54. The _____ the ratio of municipal bond yields to corporate bond yields the _____ the cutoff tax bracket where more individuals will prefer to hold municipal debt.

- A. higher; lower
- B. lower; lower
- C. lower; higher
- D. higher; higher

55. Which of the following types of bonds are excluded from most bond indices?

- A. Corporate bonds
- B. Junk bonds
- C. Municipal bonds
- D. None of the above

56. The Hang Seng index reflects market performance on which of the following major stock markets?

- A. Japan
- B. Singapore
- C. Taiwan
- D. Hong Kong

57. The Standard and Poors 500 is a(n) _____ weighted index.

- A. equally
- B. price
- C. value
- D. share

58. A firm that fails to pay dividends on its preferred stock is said to be _____.

- A. insolvent
- B. in arrears
- C. insufferable
- D. delinquent

59. Large well-known companies often issue their own short term unsecured debt notes directly to the public, rather than borrowing from banks, their notes are called _____.

- A. certificates of deposit
- B. repurchase agreements
- C. banker's acceptances
- D. commercial paper

60. Which of the following is most like a short-term collateralized loan?

- A. Certificate of deposit
- B. Repurchase agreement
- C. Banker's acceptance
- D. Commercial paper

61. Eurodollars are _____.

- A. dollar denominated deposits at any foreign bank or foreign branch of an American bank
- B. dollar denominated bonds issued by firms outside their home market
- C. currency issued by Euro Disney and traded in France
- D. dollars that wind up in banks as a result of money laundering activities

62. Which of the following is used to back international sales of goods and services?

- A. Certificate of deposit
- B. Banker's acceptance
- C. Eurodollar deposits
- D. Commercial paper

63. Treasury notes have initial maturities between _____ years.

- A. 2 and 4
- B. 5 and 10
- C. 10 and 30
- D. 1 and 10

64. Which of the following are not characteristic of common stock ownership?

- A. Residual claimant
- B. Unlimited liability
- C. Voting rights
- D. Limited life of the security

65. If you thought prices of stock would be rising over the next few months you may wish to _____ on the stock.

- A. purchase a call option
- B. purchase a put option
- C. sell a futures contract
- D. place a short sale order

66. A typical bond price quote includes all but which one of the following?

- A. Daily high price for the bond
- B. Closing bond price
- C. Yield to maturity
- D. Dividend yield

67. What are business firms most likely to use derivative securities for?

- A. Hedging
- B. Speculating
- C. Doing calculus problems
- D. Market making

68. What would you expect to have happened to the spread between yields on commercial paper and Treasury bills immediately after September 11, 2001?

- A. No change, as both yields will remain the same.
- B. Increase, the spread usually increases in response to a crisis.
- C. Decrease, the spread usually decreases in response to a crisis.
- D. No change, as both yields will move in the same direction.

69. A stock quote indicates a stock price of \$60 and a dividend yield of 3%. The latest quarterly dividend received by stock investors must have been _____ per share.

- A. \$0.55
- B. \$1.80
- C. \$0.45
- D. \$1.25

70. Three stocks have share prices of \$12, \$75, and \$30 with total market values of \$400 million, \$350 million and \$150 million respectively. If you were to construct a price-weighted index of the three stocks what would be the index value?

- A. 300
- B. 39
- C. 43
- D. 30

71. Which of the following is not considered a money market investment?

- A. Bankers acceptances
- B. Eurodollar
- C. Repurchase agreement
- D. Treasury note

72. The Federal Reserve Board of Governors directly controls which of the following interest rates?

- A. Bankers acceptances
- B. Brokers call
- C. Federal funds
- D. LIBOR

73. You decide to purchase an equal number of shares of stocks of firms to create a portfolio. If you wished to construct an index to track your portfolio performance your best match for your portfolio would be to construct a/an _____.

- A. value weighted index
- B. equal weighted index
- C. price weighted index
- D. bond price index

74. In a _____ index changes in the value of the stock with the greatest market value will move the index value the most everything else equal.

- A. value weighted index
- B. equal weighted index
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75. A corporation in a 34% tax bracket invests in the preferred stock of another company and earns a 6% pre-tax rate of return. An individual investor in a 15% tax bracket invests in the same preferred stock and earns the same pre-tax return. The after tax return to the corporation is _____ and the after tax return to the individual investor is _____.

- A. 3.96%; 5.1%
- B. 5.39%; 5.1%
- C. 6.00%; 6.00%
- D. 3.96%; 6.00%

76. All but which one of the following indices is value weighted?

- A. Nasdaq Composite
- B. S&P 500
- C. Wilshire 5000
- D. DJIA

77. What is the tax exempt equivalent yield on a 9% bond yield given a marginal tax rate of 28%?

- A. 6.48%
- B. 7.25%
- C. 8.02%
- D. 9.00%

78. A tax free municipal bond provides a yield of 3.2%. What is the equivalent taxable yield on the bond given a 35% tax bracket?

- A. 3.20%
- B. 3.68%
- C. 4.92%
- D. 5.00%

79. An index computed from a simple average of returns is a/an _____.

- A. equal weighted index
- B. value weighted index
- C. price weighted index
- D. share weighted index

80. A tax free municipal bond provides a yield of 2.34%. What is the equivalent taxable yield on the bond given a 28% tax bracket?

- A. 2.34%
- B. 2.68%
- C. 3.25%
- D. 4.92%

81. The Chompers Index is a price weighted stock index based on the 3 largest fast food chains. The stock prices for the three stocks are \$54, \$23, and \$44. What is the price weighted index value of the Chompers Index?

- A. 23.43
- B. 35.36
- C. 40.33
- D. 49.58

82. The Hydro Index is a price weighted stock index based on the 5 largest boat manufacturers in the nation. The stock prices for the five stocks are \$10, \$20, \$80, \$50 and \$40. The price of the last stock was just split 2 for 1 and the stock price was halved from \$40 to \$20. What is the new divisor for a price weighted index?

- A. 5.00
- B. 4.85
- C. 4.50
- D. 4.75

83. A benchmark index has three stocks priced at \$23, \$43, and \$56. The number of outstanding shares for each is 350,000 shares, 405,000 shares, and 553,000 shares, respectively. If the market value weighted index was 970 yesterday and the prices changed to \$23, \$41, and \$58, what is the new index value?

- A. 960
- B. 970
- C. 975
- D. 985

84. A benchmark market value index is comprised of three stocks. Yesterday the three stocks were priced at \$12, \$20, and \$60. The number of outstanding shares for each is 600,000 shares, 500,000 shares, and 200,000 shares, respectively. If the stock prices changed to \$16, \$18, and \$62 today respectively, what is the one day rate of return on the index?

- A. 5.78%
- B. 4.35%
- C. 6.16%
- D. 7.42%

85. Which of the following mortgage scenarios will benefit the homeowner the most?

- A. Adjustable rate mortgage when interest rate increases.
- B. Fixed rate mortgage when interest rates falls.
- C. Fixed rare mortgage when interest rate rises.
- D. None of the above, as banker's interest will always be protected.

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Difficulty: Easy

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$$\$9878.50 = \$10,000 \times \left[1 - \frac{(0.0486 \times 90)}{360} \right]$$

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- C. 5.47%
- D. 5.74%

$$\$9800 = \$10,000 \times \left[1 - \frac{(0.0480 \times 150)}{360} \right] \quad \left(\frac{\$10,000}{9800} - 1 \right) \times \frac{365}{150} = 4.97\%$$

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- C. mortgage pass-through security**
- D. preferred stock

Difficulty: Easy

34. Which of the following indices are market-value weighted?

- I. The NYSE Composite
- II. The S&P 500
- III. The Wilshire 5000
- A. I and II only
- B. II and III only
- C. I and III only
- D. I, II and III**

Difficulty: Easy

35. The interest rate charged by large banks in London to lend money among themselves is called _____.

- A. the prime rate
- B. the discount rate
- C. the federal funds rate
- D. LIBOR**

Difficulty: Easy

36. A firm that has large securities holdings that wishes to raise money for a short length of time may be able to find the cheapest financing from which of the following?

- A. Reverse repurchase agreement
- B. Banker's acceptance
- C. Commercial paper
- D. Repurchase agreement**

Difficulty: Hard

37. Currently the Dow Jones Industrial Average is computed by _____.
A. adding the prices of 30 large "blue-chip" stocks and dividing by 30
B. calculating the total market value of the 30 firms in the index and dividing by 30
C. measuring the current total market value of the 30 stocks in the index relative to the total value on the previous day
D. adding the prices of 30 large "blue-chip" stocks and dividing by a divisor adjusted for stock splits and large stock dividends

Difficulty: Hard

38. An investor purchases one municipal and one corporate bond that pay rates of return of 5.00% and 6.40% respectively. If the investor is in the 15% tax bracket, his after tax rates of return on the municipal and corporate bonds would be respectively
A. 5.00% and 6.40%
B. 5.00% and 5.44%
C. 4.25% and 6.40%
D. 5.75% and 5.44%

After-tax return on municipal bond = .05

After-tax return on corporate bond = $.064(1 - .15) = 0.0544 = 5.44\%$

Difficulty: Medium

39. If a treasury note has a bid price of \$996.25, the quoted bid price in the Wall Street Journal would be _____.
A. 99:25
B. 99:63
C. 99:20
D. 99:08

$$\text{Quoted Price} = 996.25 \left(\frac{100}{1,000} \right) = 99.625 = 99 + \left(0.625 \times \frac{32}{32} \right) = 99 \frac{20}{32} = 99 : 20$$

Difficulty: Medium

40. TIPS are _____.

- A. Treasury bonds that pay a variable rate of interest
- B. U.K. bonds that protect investors from default risk
- C. securities that trade on the Toronto stock index
- D.** Treasury bonds that protect investors from inflation

Difficulty: Medium

41. The price quotations of treasury bonds in the Wall Street Journal show a bid price of 102:12 and an ask price of 102:14. If you sold the bond you expect to receive _____.

- A. \$1,024.75
- B. \$1,024.38
- C.** \$1,023.75
- D. \$1,022.50

$$P = \left(102 + \frac{12}{32} \right) \times \left(\frac{1,000}{100} \right) = 1,023.75$$

Difficulty: Medium

42. The Dow Jones Industrial Average is _____.

- A.** a price weighted average
- B. a value weight and average
- C. an equally weighted average
- D. an unweighted average

Difficulty: Easy

43. Investors will earn higher rates of returns on TIPS than equivalent default risk standard bonds if _____.

- A. inflation is lower than anticipated over the investment period
- B. inflation is higher than anticipated over the investment period**
- C. the U.S. dollar increases in value against the euro
- D. the spread between commercial paper and Treasury securities remains low

Difficulty: Medium

44. Preferred stock is like long-term debt in that _____.

- A. it gives the holder voting power regarding the firm's management
- B. it promises to pay to its holder a fixed stream of income each year**
- C. the preferred dividend is a tax-deductible expense for the firm
- D. in the event of bankruptcy preferred stock has equal status with debt

Difficulty: Medium

45. Which of the following does not approximate the performance of a buy and hold portfolio strategy?

- A. An equally weighted index
- B. A price weighted index
- C. A value weighted index**
- D. Weights are not a factor in this situation

Difficulty: Medium

46. In calculating the Dow Jones Industrial Average, the adjustment for a stock split occurs _____.

- A. automatically
- B. by adjusting the divisor**
- C. by adjusting the numerator
- D. by adjusting the market value weights

Difficulty: Medium

47. If the market prices of the 30 stocks in the Dow Jones Industrial Average all change by the same dollar amount on a given day, assuming there are no stock splits which stock will have the greatest impact on the average?

- A. The one with the highest price
- B. The one with the lowest price
- C.** All 30 stocks will have the same impact
- D. The answer cannot be determined by the information given

Difficulty: Medium

48. A bond issued by the State of Alabama is priced to yield 6.25%. If you are in the 28% tax bracket this bond would provide you with an equivalent taxable yield of _____.

- A. 4.50%
- B. 7.25%
- C.** 8.68%
- D. none of the above

Difficulty: Medium Feedback: $8.68\% = 6.25\% / (1 - 0.28)$

49. The purchase of a futures contract gives the buyer _____.

- A. the right to buy an item at a specified price
- B. the right to sell an item at a specified price
- C.** the obligation to buy an item at a specified price
- D. the obligation to sell an item at a specified price

Difficulty: Easy

50. Ownership of a put option entitles the owner to the _____ to _____ a specific stock, on or before a specific date, at a specific price.

- A. right, buy
- B.** right, sell
- C. obligation, buy
- D. obligation, sell

Difficulty: Easy

51. An investor in a 28% tax bracket is trying to decide whether to invest in a municipal bond or a corporate bond. She looks up municipal bond yields (r_m) but wishes to calculate the taxable equivalent yield r . The formula she should use is given by _____.

- A. $r = r_m * (1 - 28\%)$
- B. $r = r_m / (1 - 72\%)$
- C. $r = r_m * (1 - 72\%)$
- D.** $r = r_m / (1 - 28\%)$

Difficulty: Hard

52. June call and put options on King Books Inc are available with exercise prices of \$30, \$35 and \$40. Among the different exercise prices, the call option with the _____ exercise price and the put option with the _____ exercise price will have the greatest value.

- A. \$40; \$30
- B.** \$30; \$40
- C. \$35; \$35
- D. \$40; \$40

Difficulty: Medium

53. Ownership of a call option entitles the owner to the _____ to _____ a specific stock, on or before a specific date, at a specific price.

- A.** right, buy
- B. right, sell
- C. obligation, buy
- D. obligation, sell

Difficulty: Easy

54. The _____ the ratio of municipal bond yields to corporate bond yields the _____ the cutoff tax bracket where more individuals will prefer to hold municipal debt.

- A.** higher; lower
- B. lower; lower
- C. lower; higher
- D. higher; higher

Difficulty: Hard

55. Which of the following types of bonds are excluded from most bond indices?

- A. Corporate bonds
- B.** Junk bonds
- C. Municipal bonds
- D. None of the above

Difficulty: Medium

56. The Hang Seng index reflects market performance on which of the following major stock markets?

- A. Japan
- B. Singapore
- C. Taiwan
- D.** Hong Kong

Difficulty: Medium

57. The Standard and Poors 500 is a(n) _____ weighted index.

- A. equally
- B. price
- C.** value
- D. share

Difficulty: Easy

58. A firm that fails to pay dividends on its preferred stock is said to be _____.

- A. insolvent
- B.** in arrears
- C. insufferable
- D. delinquent

Difficulty: Medium

59. Large well-known companies often issue their own short term unsecured debt notes directly to the public, rather than borrowing from banks, their notes are called _____.

- A. certificates of deposit
- B. repurchase agreements
- C. banker's acceptances
- D.** commercial paper

Difficulty: Easy

60. Which of the following is most like a short-term collateralized loan?

- A. Certificate of deposit
- B.** Repurchase agreement
- C. Banker's acceptance
- D. Commercial paper

Difficulty: Medium

61. Eurodollars are _____.

- A.** dollar denominated deposits at any foreign bank or foreign branch of an American bank
- B. dollar denominated bonds issued by firms outside their home market
- C. currency issued by Euro Disney and traded in France
- D. dollars that wind up in banks as a result of money laundering activities

Difficulty: Easy

62. Which of the following is used to back international sales of goods and services?

- A. Certificate of deposit
- B.** Banker's acceptance
- C. Eurodollar deposits
- D. Commercial paper

Difficulty: Medium

63. Treasury notes have initial maturities between _____ years.

- A. 2 and 4
- B. 5 and 10
- C. 10 and 30
- D.** 1 and 10

Difficulty: Easy

64. Which of the following are not characteristic of common stock ownership?

- A. Residual claimant
- B.** Unlimited liability
- C. Voting rights
- D. Limited life of the security

Difficulty: Easy

65. If you thought prices of stock would be rising over the next few months you may wish to _____ on the stock.

- A.** purchase a call option
- B. purchase a put option
- C. sell a futures contract
- D. place a short sale order

Difficulty: Medium

66. A typical bond price quote includes all but which one of the following?

- A. Daily high price for the bond
- B. Closing bond price
- C. Yield to maturity
- D.** Dividend yield

Difficulty: Easy

67. What are business firms most likely to use derivative securities for?

- A.** Hedging
- B. Speculating
- C. Doing calculus problems
- D. Market making

Difficulty: Medium

68. What would you expect to have happened to the spread between yields on commercial paper and Treasury bills immediately after September 11, 2001?

- A. No change, as both yields will remain the same.
- B.** Increase, the spread usually increases in response to a crisis.
- C. Decrease, the spread usually decreases in response to a crisis.
- D. No change, as both yields will move in the same direction.

Difficulty: Hard

69. A stock quote indicates a stock price of \$60 and a dividend yield of 3%. The latest quarterly dividend received by stock investors must have been _____ per share.

- A. \$0.55
- B. \$1.80
- C.** \$0.45
- D. \$1.25

$$\frac{\$60 \times 0.030}{4} = \$0.45$$

Difficulty: Medium

70. Three stocks have share prices of \$12, \$75, and \$30 with total market values of \$400 million, \$350 million and \$150 million respectively. If you were to construct a price-weighted index of the three stocks what would be the index value?

- A. 300
- B.** 39
- C. 43
- D. 30

$$Index = (12 + 75 + 30)/3 = 39$$

Difficulty: Medium

71. Which of the following is not considered a money market investment?

- A. Bankers acceptances
- B. Eurodollar
- C. Repurchase agreement
- D.** Treasury note

Difficulty: Easy

72. The Federal Reserve Board of Governors directly controls which of the following interest rates?

- A. Bankers acceptances
- B. Brokers call
- C. Federal funds
- D. LIBOR

Difficulty: Easy

73. You decide to purchase an equal number of shares of stocks of firms to create a portfolio. If you wished to construct an index to track your portfolio performance your best match for your portfolio would be to construct a/an _____.

- A. value weighted index
- B. equal weighted index
- C. price weighted index
- D. bond price index

Difficulty: Hard

74. In a _____ index changes in the value of the stock with the greatest market value will move the index value the most everything else equal.

- A. value weighted index
- B. equal weighted index
- C. price weighted index
- D. bond price index

Difficulty: Medium

75. A corporation in a 34% tax bracket invests in the preferred stock of another company and earns a 6% pre-tax rate of return. An individual investor in a 15% tax bracket invests in the same preferred stock and earns the same pre-tax return. The after tax return to the corporation is _____ and the after tax return to the individual investor is _____.

- A. 3.96%; 5.1%
- B.** 5.39%; 5.1%
- C. 6.00%; 6.00%
- D. 3.96%; 6.00%

After-tax return to corporate investor after 70% exclusion = $0.06 - (0.06 * 0.30) * 0.34 = 5.39\%$

After-tax return to individual investor = $0.06 * (1 - 0.15) = 5.1\%$

Difficulty: Hard

76. All but which one of the following indices is value weighted?

- A. Nasdaq Composite
- B. S&P 500
- C. Wilshire 5000
- D.** DJIA

Difficulty: Easy

77. What is the tax exempt equivalent yield on a 9% bond yield given a marginal tax rate of 28%?

- A.** 6.48%
- B. 7.25%
- C. 8.02%
- D. 9.00%

after tax yield = $.09(1 - .28) = .0648$

Difficulty: Medium

78. A tax free municipal bond provides a yield of 3.2%. What is the equivalent taxable yield on the bond given a 35% tax bracket?

- A. 3.20%
- B. 3.68%
- C. 4.92%**
- D. 5.00%

$$\text{Yield} = \frac{.032}{1 - .35} = 0.0492$$

Difficulty: Medium

79. An index computed from a simple average of returns is a/an _____.

- A. equal weighted index**
- B. value weighted index
- C. price weighted index
- D. share weighted index

Difficulty: Medium

80. A tax free municipal bond provides a yield of 2.34%. What is the equivalent taxable yield on the bond given a 28% tax bracket?

- A. 2.34%
- B. 2.68%
- C. 3.25%**
- D. 4.92%

$$\text{Yield} = \frac{.0234}{1 - .28} = 0.0325$$

Difficulty: Medium

81. The Chompers Index is a price weighted stock index based on the 3 largest fast food chains. The stock prices for the three stocks are \$54, \$23, and \$44. What is the price weighted index value of the Chompers Index?

- A. 23.43
- B. 35.36
- C. 40.33**
- D. 49.58

$$\text{Index} = \frac{54 + 23 + 44}{3} = 40.33$$

Difficulty: Medium

82. The Hydro Index is a price weighted stock index based on the 5 largest boat manufacturers in the nation. The stock prices for the five stocks are \$10, \$20, \$80, \$50 and \$40. The price of the last stock was just split 2 for 1 and the stock price was halved from \$40 to \$20. What is the new divisor for a price weighted index?

- A. 5.00
- B. 4.85
- C. 4.50**
- D. 4.75

$$\text{Index}_0 = \frac{\$10 + \$20 + \$80 + \$50 + \$40}{5} = 40$$

$$\text{Index}_1 = \frac{\$10 + \$20 + \$80 + \$50 + \$20}{X} = 40; X = 4.50$$

Difficulty: Hard

Chapter 02 - Asset Classes and Financial Instruments

83. A benchmark index has three stocks priced at \$23, \$43, and \$56. The number of outstanding shares for each is 350,000 shares, 405,000 shares, and 553,000 shares, respectively. If the market value weighted index was 970 yesterday and the prices changed to \$23, \$41, and \$58, what is the new index value?

- A. 960
- B. 970
- C. 975
- D. 985

$$\text{Index} = \frac{\$23 \times 350000 + \$41 \times 405000 + \$58 \times 553000}{\$23 \times 350000 + \$43 \times 405000 + \$56 \times 553000} \times 970 = 975$$

Difficulty: Hard

84. A benchmark market value index is comprised of three stocks. Yesterday the three stocks were priced at \$12, \$20, and \$60. The number of outstanding shares for each is 600,000 shares, 500,000 shares, and 200,000 shares, respectively. If the stock prices changed to \$16, \$18, and \$62 today respectively, what is the one day rate of return on the index?

- A. 5.78%
- B. 4.35%
- C. 6.16%
- D. 7.42%

$$\text{Index return} = \left[\frac{\$16 \times 600000 + \$18 \times 500000 + \$62 \times 200000}{\$12 \times 600000 + \$20 \times 500000 + \$60 \times 200000} \right] - 1 = 6.164\%$$

Difficulty: Hard

85. Which of the following mortgage scenarios will benefit the homeowner the most?

- A. Adjustable rate mortgage when interest rate increases.
- B. Fixed rate mortgage when interest rates falls.
- C. Fixed rare mortgage when interest rate rises.
- D. None of the above, as banker's interest will always be protected.

Difficulty: Medium