Review for Exam 1

Instructions: Please read carefully

- The exam will have 21 multiple choice questions and 5 work problems.
- Questions in the multiple choice section will be either concept or calculation questions. The calculation questions will be similar to those in the homework and review. However, the concept questions will be related to any topic we have covered in the class. The concept questions in the review are only some sample questions. You should NOT study only topics in the review.
- For the work problems, you need to solve the problems without knowing the possible answers. The questions will be similar to those in the homework and the review except that the possible solutions are not given.
- You can bring a formula sheet to the exam. However, you should not write definitions/concepts on the sheet.
Chapter 1

1. There would be no _______________ in an efficient stock market.
   a. underpriced or overpriced stocks
   b. returns higher than 100%
   c. commission costs
   d. taxes

2. A _______________ represents an ownership share in a corporation.
   a. bond
   b. preferred stock
   c. common stock
   d. All of the above.

3. In securities markets, the risk-return trade-off implies that assets with higher risk will offer investors _______________ expected returns.
   a. higher
   b. lower
   c. the same
   d. None of the above.

4. Allocation of the investment portfolio across broad asset classes refers to the _______________.
   a. security analysis
   b. top-down portfolio construction
   c. asset allocation
   d. None of the above.

5. Commercial banks are _______________.
   a. lending institutions
   b. borrowing institutions
   c. commercial intermediaries
   d. financial intermediaries

6. Investors can purchase new issues of securities in the _______________ market.
   a. secondary
   b. primary
   c. new
   d. IPO

7. American Depository Receipts are claims to _______________.
   a. foreign stocks
   b. American stocks
   c. North American stocks
   d. European stocks

8. Firms that specialize in helping companies raise capital by selling securities are called _______________.
   a. industrial banks
   b. commercial banks
   c. investment banks
9. _______________ are financial assets.
   a. Options
   b. Factories
   c. Commercial properties
   d. All of the above are financial assets

10. Portfolio manager with a passive investment strategy will manage a portfolio by
    _______________.
    a. holding a diversified portfolio
    b. selecting mispriced securities
    c. timing the performance of securities
    d. None of the above.

Chapter 2

11. A dollar denominated deposit at a London bank is called ______.
    A) eurodollars
    B) LIBOR
    C) fed funds
    D) banker's acceptance

12. Money market securities are sometimes referred to as "cash equivalent" because
    A) they are marketable
    B) they are liquid
    C) they are low-risk
    D) all of the above

13. ______ computes over 50 country indexes.
    A) Dow Jones
    B) The Federal Reserve
    C) NASDAQ
    D) MSCI

14. Deposits of commercial banks at the Federal Reserve are called ______.
    A) bankers acceptances
    B) federal funds
    C) repurchase agreements
    D) time deposits

15. 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

16. A ________ gives its holder the right to buy an asset for a specified exercise price on or before a specified expiration date.
   A) call option
   B) futures contract
   C) put option
   D) none of the above

17. 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) adding the prices of the 30 stocks in the index and dividing by a divisor
   D) adding the prices of the 500 stocks in the index and dividing by a divisor

18. Purchase of a futures contract involves ________
   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

Chapter 3

19. Underwriting is one of the services provided by ____.
   A) the SEC
   B) investment bankers
   C) publicly traded companies
   D) FDIC

20. A level _____ subscriber to the NASDAQ system may enter bid and ask prices.
   A) 1
   B) 2
   C) 3
   D) 4

21. ________ is a false statement regarding specialists.
   A) On a stock exchange all buy or sell orders are negotiated through a specialist
   B) Specialists can not trade for their own accounts
   C) Specialists earn income from commissions and spreads in stock prices
   D) Specialists stand ready to trade at quoted bid and ask prices
22. The bulk of most initial public offerings (IPOs) of equity securities go to __________.
   A) institutional investors
   B) individual investors
   C) the firm's current shareholders
   D) day traders

23. __________ is a false statement about the function of investment bankers.
   A) They act as intermediaries between issuers of stocks and investors
   B) They purchase new securities from corporations and sell them to the public
   C) They are commercial banks that accept deposits from savers and lend them out to companies
   D) They act as advisers to companies in helping them analyze their financial needs and find buyers for their securities

24. The bid-ask spread exists because of ____________.
   A) market inefficiencies
   B) poor communication
   C) the need for dealers to cover expenses and make a modest profit
   D) none of the above

25. The cost of buying and selling a stock include __________.
   A) broker's commissions
   B) dealer's bid-asked spread
   C) price concessions investors may be forced to make
   D) all of the above

26. You short-sell 200 shares of Tuckerton Trading Co., now selling for $50 per share. What is your maximum possible loss?
   A) $50
   B) $150
   C) $10,000
   D) unlimited

27. __________ often accompany short sales, and are used to limit potential losses from the short position.
   A) Limit orders
   B) Restricted orders
   C) Limit-loss orders
   D) Stop-buy orders
Chapter 9

28. The primary difference between Treasury notes and bonds is _________.
   A) maturity at issue
   B) default risk
   C) coupon rate
   D) tax status

29. A __________ bond is a bond where the bondholder has the right to cash in the bond before maturity at a specific price after a specific date.
   A) callable
   B) coupon
   C) put
   D) treasury

30. Bonds with coupon rates that fall when the general level of interest rates rise are called _____________.
   A) invertible bonds
   B) convertible bonds
   C) reverse floaters
   D) index bonds

31. The issuer of a ___ bond may choose to pay interest either in cash or in additional bonds.
   A) asset backed bonds
   B) TIPS
   C) catastrophe
   D) pay in kind

32. In an era of particularly low interest rates, which of the following bonds is most likely to be called?
   A) zero coupon bonds
   B) coupon bonds selling at a discount
   C) coupon bonds selling at a premium
   D) floating rate bonds

33. Consider the expectations theory of the term structure of interest rates. If the yield curve is downward sloping, this indicates that investors expect short-term interest rates to _________ in the future.
   A) increase
   B) decrease
   C) not change
   D) change in an unpredictable manner
34. A convertible bond has a par value of $1,000 but its current market price is $950. The current price of the issuing company's stock is $19 and the conversion ratio is 40 shares. The bond's conversion premium is __________.
A) $50.00  
B) $190.00  
C) $200.00  
D) $240.00

35. A coupon bond which pays interest of $40 annually, has a par value of $1,000, matures in 5 years, and is selling today at a $159.71 discount from par value. The actual yield to maturity on this bond is __________.
A) 5%  
B) 6%  
C) 7%  
D) 8%

36. A coupon bond which pays interest semi-annually, has a par value of $1,000, matures in 5 years, and has a yield to maturity of 8%. If the coupon rate is 10%, the intrinsic value of the bond today will be __________.
A) $855.55  
B) $1,000  
C) $1,081  
D) $1,100

37. A coupon bond pays semi-annual interest is reported as having an ask price of 117% of its $1,000 par value in the Wall Street Journal. If the last interest payment was made 2 months ago and the coupon rate is 6%, the invoice price of the bond will be __________.
A) $1,140  
B) $1,170  
C) $1,180  
D) $1,200

38. You purchased a 5-year annual interest coupon bond one year ago. Its coupon interest rate was 6% and its par value was $1,000. At the time you purchased the bond, the yield to maturity was 4%. If you sold the bond after receiving the first interest payment and the bond's yield to maturity had changed to 3%, your annual total rate of return on holding the bond for that year would have been __________.
A) 5.00%  
B) 5.51%  
C) 7.61%  
D) 8.95%
39. Consider the following $1,000 par value zero-coupon bonds:

<table>
<thead>
<tr>
<th>Bond</th>
<th>Years to Maturity</th>
<th>Yield to Maturity</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>1</td>
<td>6.00%</td>
</tr>
<tr>
<td>B</td>
<td>2</td>
<td>7.00%</td>
</tr>
<tr>
<td>C</td>
<td>3</td>
<td>8.32%</td>
</tr>
<tr>
<td>D</td>
<td>4</td>
<td>8.49%</td>
</tr>
<tr>
<td>E</td>
<td>5</td>
<td>10.70%</td>
</tr>
</tbody>
</table>

The expected one-year interest rate three years from now should be __________.
A) 7.00%
B) 8.00%
C) 9.00%
D) 10.00%

40. A bond pays a semi-annual coupon and the last coupon was paid 74 days ago. If the annual coupon payment is $65, what is the accrued interest?
A) $13.21
B) $14.12
C) $15.44
D) $16.32

Chapter 10

41. Investors in a common stock mutual fund incur an income tax liability when
   ____________.
   a. they sell their mutual fund shares at a gain
   b. the mutual fund sells stock in its portfolio at a gain
   c. the mutual fund receives dividends on the stock owned by the mutual fund
   d. all of the above

42. Cost incurred by a mutual fund in managing the fund, including administrative expenses and advisory fees, are referred to as the fund's ____________.
   a. 12b-1 charges
   b. front-end load
   c. management fee
   d. operating expenses

43. Which of the following is an advantage to investors of exchange traded funds (ETFs) that is not available to investors in open-end mutual funds?
   a. ETFs allow investors to invest in broad U.S. market indexes as well as international indexes.
   b. Investors can avoid incurring an expense in the form of a bid-ask spread by purchasing an ETF rather than investing in an open-end mutual fund.
ETFs offer a potential tax advantage to investors who incur capital gains taxes only when they sell ETF shares.

d. ETF prices can not deviate from net asset value.

44. A type of mutual fund that maintains relatively stable proportions of its funds invested in equities and in fixed-income securities is called a _______________.
   a. specialized sector fund
   b. index fund
   c. asset allocation fund
   d. balanced fund

45. A real estate investment trust is a(n) ________________.
   a. open-end mutual fund that invests primarily in mortgage and construction loans
   b. closed-end mutual fund that invests directly in real estate
   c. hedge fund that invests in real estate or loans secured by real estate
   d. none of the above

46. A mutual fund has $500 million in assets at the beginning of the year and 20 million shares outstanding throughout the year. The assets in the fund increase in price by 10%. The fund charges 12b-1 fees of 1%. This fee is imposed on year-end asset values. There are no capital gains distributions from the fund during the year. What is the end of year net asset value for the fund?
   a. $25.00
   b. $27.23
   c. $27.25
   d. $27.50

47. Shares of a closed-end fund ________________.
   a. always trade at net asset value, because large investors can redeem their shares in the fund for a portfolio of stocks
   b. always trade at net asset value, because all investors can redeem their shares in the fund for net asset value
   c. can trade at a substantial discount from net asset value, although such a discount tends to dissipate over time
   d. can trade at a substantial discount from net asset value but can not trade at a premium above net asset value

48. A closed-end fund has a portfolio currently worth $350 million. The fund has liabilities of $5 million and 17 million shares outstanding. What is the net asset value of the fund?
   a. $20.88
   b. $20.29
   c. $20.59
   d. $29.17
49. Which of the following statements is true about hedge funds?
   a. Hedge funds are mutual funds that specialize in derivative investments designed primarily for hedging purposes.
   b. Because of their large size and varied investments, hedge funds are closely regulated by both the SEC and the CFTC.
   c. The term hedge fund derives from a common hedge fund strategy based on anticipated changes in relative valuations in two market sectors.
   d. Investments in hedge funds are very liquid, which means that investors in a hedge fund can withdraw their investments at any time without risk of loss in market value.

50. An open-end fund has a net asset value of $13.40 per share. The fund is sold with a front-end load of 4%. What is the offering price?
   a. $13.96
   b. $12.86
   c. $13.94
   d. $12.88
There is no upper limit to the price of a share of stock, therefore no upper limit the price you will have to pay to replace the 200 shares of Tuckerton.

Conversion Premium = 950-40(19) = 190.00

At k = 8%, V_0 = 40(3.993) + 1,000(.681) = 840.29
36. Answer: C
\[ V_0 = 50(8.11) + 1,000(.676) = 1081 \]

37. Answer: C

\[ \text{Invoice Price} = 1,000(1.17) + 60(2/12) = 1,180 \]

38. Answer: C

\[ V_1 = 60(4.452) + 1,000(.822) = 1,089.12 \]
\[ V_0 = 60(3.717) + 1,000(.889) = 1,112.02 \]
\[ \text{HPR} = [60 + (1,112.02 - 1,089.12)]/1,089.12 = 7.61\% \]

39. Answer: C

\[ \left(1 + \frac{.0849}{4}\right)^4 - \left(1 + \frac{.0832}{3}\right)^3 - 1 = .09 \]

40. Answer: A

\[ \text{Accrued interest} = (65/2) \times (74/182) = 13.21 \]

41. Answer: D

42. Answer: D

43. Answer: C

44. Answer: D

45. Answer: D

46. Answer: B

47. Answer: C

48. Answer: B

49. Answer: C

50. Answer: A