

Chapter 2: THE DOMESTIC AND INTERNATIONAL FINANCIAL MARKETPLACE

MULTIPLE CHOICE

1. The difference between merchandise exports and imports is known as the ____.
- transaction exposure
 - difference in purchasing power
 - merchandise trade balance
 - import/export reserve

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
 LOC: Understand derivative market TOP: The global economy

2. A multinational firm ____.
- has direct investments in manufacturing facilities in more than one country
 - exports finished goods for sale in another country
 - imports raw materials from another country
 - has a manufacturing representative in another country

ANS: A PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
 LOC: Understand the role of the finance function TOP: The global economy

3. The interest rate at which banks in the Eurocurrency market lend to each other is known as the ____.
- Eurocurrency currency rate (ECR)
 - London interbank offer rate
 - exchange rate
 - interest rate parity

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
 LOC: Knowledge of financial markets and interest rates TOP: The Eurocurrency market

4. If Japanese yen are deposited in a bank in Paris, the deposits would be called ____.
- Eurofrancs
 - European Currency Unit
 - Eurobond
 - Euroyen

ANS: D PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
 LOC: Knowledge of financial markets and interest rates TOP: The Eurocurrency market

5. An exchange rate quoted as \$1.47 per British pound is known as a ____ quote.
- hedge
 - direct
 - futures
 - indirect

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Analytic skills
 LOC: Understand derivative market TOP: Direct and indirect quotes

6. If the spot rate for Swiss francs is \$0.6658/franc and the 180-day forward rate is \$0.6637, the market is indicating that the Swiss franc is expected to
- strengthen relative to the dollar
 - weaken relative to the ECU

- c. lose value relative to the dollar over the next 6 months
- d. gain value relative to the dollar over the next 6 months

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand derivative market TOP: Forward rates

7. Which of the following is not a correct statement about foreign currency futures?
- a. futures contracts have a standardized maturity date
 - b. futures contracts are an exchange-traded agreement
 - c. futures contracts are not liquid
 - d. futures contracts are "marked to market" daily

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand derivative market TOP: Foreign currency futures

8. The most important foreign currency futures market in the United States is the ____.
- a. Chicago Board of Trade
 - b. New York Mercantile Exchange
 - c. Commodity Exchange
 - d. Chicago Mercantile Exchange

ANS: D PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand derivative market TOP: Foreign currency futures

9. The buyer of a foreign currency call option has the ____ a fixed amount of a foreign currency.
- a. right to sell
 - b. right but not the obligation to buy
 - c. obligation to buy, only at expiration,
 - d. obligation to buy

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand derivative market TOP: Foreign currency options

10. Eurodollars are U.S. dollars that have been deposited in
- a. foreign banks
 - b. foreign branches of U.S. banks
 - c. foreign subsidiaries
 - d. foreign banks and foreign branches of U.S. banks

ANS: D PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand derivative market TOP: The Eurocurrency market

11. If the exchange rate from U.S. dollars to Canadian dollars is \$0.80/Canadian dollar, then the exchange rate from Canadian dollars to U.S. dollars is
- a. 0.80 Canadian \$/US dollar
 - b. \$1.25 Canadian \$/US dollar
 - c. \$1.20 Canadian \$/US dollar
 - d. \$8.00 Canadian \$/US dollar

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Analytic skills
LOC: Understand derivative market TOP: Direct and indirect quotes

12. If the exchange rate from U.S. dollars to Swiss francs is \$0.20/franc, then the exchange rate from francs to dollars is
- a. 0.20 francs/dollar
 - b. 0.80 francs/dollar

- c. 5.0 francs/dollar
- d. 2.0 francs/dollar

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Analytic skills
LOC: Understand derivative market TOP: Foreign currencies and exchange rates

13. If the spot rate (in U.S. dollars) for Japanese Yen is 0.00703 and the 180 day forward rate is 0.00717, then the Yen is trading at a(n) ____.
- a. expected gain
 - b. premium
 - c. reciprocal
 - d. discount

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand derivative market TOP: Foreign currencies and exchange rates

14. If the forward (direct quote) exchange rate is lower than the spot rate, then the currency is said to be trading at a ____.
- a. forward premium
 - b. forward gain
 - c. forward discount
 - d. forward loss

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand derivative market TOP: Foreign currencies and exchange rates

15. Financial middlemen include
- a. securities brokers
 - b. securities dealers
 - c. investment bankers
 - d. all of the above

ANS: D PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function
TOP: An overview of the U.S. financial system

16. The following are listed security exchanges in the United States:
- a. New York Stock Exchange
 - b. Pacific Exchange
 - c. Cincinnati Exchange
 - d. All the above are listed exchanges

ANS: D PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates TOP: Listed security exchanges

17. The Standard and Poor's 500 Stock Price Index is a ____ index.
- a. price weighted
 - b. market value weighted
 - c. price average
 - d. none of these answers is correct

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates TOP: Stock market indexes

18. Securities not listed on exchanges are said to be traded
- a. on the AMEX

- b. as composite transactions
- c. over the counter
- d. on the regional exchanges

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates
TOP: Security exchanges and Stock market indexes

19. Financial intermediaries include
- a. securities brokers
 - b. commercial banks
 - c. securities dealers
 - d. all of the above

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates
TOP: An overview of the U.S. financial system

20. ____ markets deal in long-term securities having maturities greater than one year.
- a. Credit
 - b. Money
 - c. Commodity futures
 - d. Capital

ANS: D PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates TOP: Money and capital markets

21. ____ markets deal in short-term securities having maturities of one year or less.
- a. Credit
 - b. Money
 - c. Capital
 - d. Capital and credit

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates TOP: Money and capital markets

22. Which of the following (if any) are *not* financial intermediaries?
- a. commercial bank
 - b. thrift institution
 - c. securities broker
 - d. all are financial intermediaries

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates
TOP: An overview of the U.S. financial system

23. In the ____ market, the firm receives the proceeds from the sale of its securities.
- a. over-the-counter
 - b. secondary
 - c. fully integrated
 - d. primary

ANS: D PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates
TOP: Primary and secondary markets

24. A savings and loan association is an example of which type of financial intermediary?
- commercial bank
 - investment company
 - finance company
 - thrift institution

ANS: D PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates TOP: Thrift institutions

25. In any economy as a whole, the actual savings for a given period of time must ____ the actual investments.
- be greater than
 - be unrelated to
 - equal
 - be less than

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates
TOP: An overview of the finance system

26. Financial intermediaries
- issue secondary claims to the lender
 - are compensated for their services by fixed fees
 - include both brokers and dealers
 - issue primary claims to the lender

ANS: A PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates
TOP: An overview of the finance system

27. The main purpose of an economy's financial system is to facilitate the transfer of funds from
- financial middlemen to financial intermediaries
 - surplus spending units to deficit spending units
 - primary claimholders to secondary claimholders
 - lenders to financial intermediaries

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates
TOP: An overview of the finance system

28. Money markets deal in securities having maturities of ____; capital market securities have maturities ____.
- less than 18 months, greater than 18 months
 - one year or less, greater than one year
 - less than 9 months, greater than 9 months
 - less than 6 months, greater than 6 months

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates TOP: Financial markets

29. Commercial banks are an important source of
- mortgage loans
 - equity loans
 - real estate loans
 - short-term loans and term loans

ANS: D PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates TOP: Commercial banks

30. Finance companies obtain a significant amount of their funds by
- issuing their own equity securities
 - accepting both demand and time deposits
 - issuing their own debt securities
 - pooling funds

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates TOP: Finance companies

31. When an investor purchases shares in a no-load common stock mutual fund, she is using a(n)
- primary intermediary
 - financial intermediary
 - over-the-counter market
 - broker

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates
TOP: Overview of the US financial system

32. The interest rate in the Eurodollar market is related to
- the DOW
 - the stock market
 - the LIBOR
 - interest rates in the United States

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates TOP: The Eurocurrency market

33. Capital markets in financially sophisticated economies are not perfectly efficient because of
- anomalous events
 - the Sun Spot theory
 - irrational investor behavior
 - anomalous events and irrational investor behavior

ANS: D PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates
TOP: Behavioral Finance perspectives

34. Commercial banks are a major source of term loans. These loans are best used for:
- financing the expansion of the business.
 - financing the establishment of overseas operations.
 - financing current assets like inventory and accounts receivable.
 - financing the payment of dividends.

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates TOP: Financial Intermediaries

35. The Dow Jones Industrial Average is calculated using the
- total market value of 30 stocks
 - price of 30 stocks
 - a weighted index of 30 stocks
 - industrial, railroad, financial, and utility stocks

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates TOP: Stock market indexes

36. Insider trading is defined as
- an individual using proper trading rules
 - an individual buying or selling using non-SEC disclosure rules
 - an individual buying or selling on the basis of material nonpublic information
 - a zero-plus game

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates
TOP: Ethical issues: insider trading

37. The U.S. financial markets are said to be highly informationally efficient. This means
- they process stock trades accurately and quickly
 - the market provides quick access to a firm's financial statements
 - they quickly reflect information relevant to determining stock value
 - accurate stock quotes are quickly available to all investors

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates
TOP: Information and capital market efficiency

38. Ex post returns differ from ____ returns in that they represent ____ values rather than ____ values.
- ex ante; estimated; actual
 - ex post; accounting; economic
 - ex ante; actual; estimated
 - ex ante; economic; accounting

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates TOP: Holding period returns

39. The fact that no investor can expect to earn excess returns based on an investment strategy using only historical stock price or return information is an example of ____ market efficiency.
- strong-form
 - weak-form
 - semiweak-form
 - semistrong-form

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function TOP: Weak-form efficiency

40. With semistrong-form market efficiency, no investor can expect to earn excess returns based on an investment strategy using any ____ information.
- past market price
 - market value
 - publicly available
 - private

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function TOP: Semistrong-form efficiency

41. In an efficient capital market, all security investments will have:
- a required rate of return that exceeds the cost of capital
 - a positive NPV

- c. a required rate of return that is zero
- d. a NPV of zero

ANS: D PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function TOP: An expected NPV of zero

42. In an efficient capital market, corporate diversification is ____.
- a. unnecessary
 - b. inexpensive
 - c. of benefit to corporate managers
 - d. of great benefit

ANS: A PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function
TOP: Expensive and unnecessary corporate diversification

43. The barriers to the free flow of capital among the major world capital markets include all of the following except:
- a. low transaction costs
 - b. taxation policies
 - c. foreign exchange risks
 - d. legal restrictions

ANS: A PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function
TOP: Market efficiency outside of the U.S.

44. For the financial manager, taxes have important implications for
- a. dividend policy
 - b. financial restructurings
 - c. capital structure policy
 - d. all of the above

ANS: D PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function
TOP: Income taxes and financial management

45. Changes in the tax code that slow down depreciation, ____ the present value of investment cash flows and, therefore, make the investment ____ desirable.
- a. decrease, more
 - b. decrease, less
 - c. increase, more
 - d. increase, less

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function
TOP: Income taxes and financial management

46. In an efficient capital market
- a. required returns equal expected returns
 - b. investors will have holding period returns equal to zero
 - c. purchase of any security yields zero profit
 - d. purchasing stocks is no better than gambling

ANS: A PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function

TOP: Implications of market efficiency

47. If the spot rate for the British pound is \$1.5077 and the 180-day forward rate is \$1.4934, what is the annualized premium (discount)?
- premium of 1.90%
 - premium of 0.97%
 - discount of (-)1.90%
 - discount of (-)0.97%

ANS: C

Solution:

$$[(\$1.4934 - \$1.5077) / (\$1.5077)](12/6)(100\%) = -1.897\%$$

PTS: 1 OBJ: TYPE: E. Prob NAT: Analytic skills
LOC: Understand derivative market TOP: Forward rates

48. If the spot rate for the Japanese yen is \$0.009204 and the 90-day forward rate is \$0.009227, what is the annualized premium (discount)?
- premium of 1.00%
 - premium of 0.50%
 - discount of -0.99%
 - premium of 0.25%

ANS: A

Solution:

$$[(.009227 - .009204)/(.009204)](12/3)(100\%) = 0.9996\%$$

PTS: 1 OBJ: TYPE: E. Prob NAT: Analytic skills
LOC: Understand derivative market TOP: Forward rates

49. Christy purchased 100 shares of Good Idea stock for \$48 last year. Yesterday she sold the stock for \$45. If she received \$4 in dividends during the time she held the security, what is her holding period return?
- 2.08%
 - 8.30%
 - 6.30%
 - 14.60%

ANS: A

Solution:

$$(\$45 - \$48 + \$4) / \$48 = 0.0208 \text{ or } 2.08\%$$

PTS: 1 OBJ: TYPE: E. Prob NAT: Analytic skills
LOC: Understand derivative market TOP: Holding period returns

50. If an investor purchased 100 shares of Biggee stock for \$30 per share, 6 months ago, and then sold the stock today for \$33 per share, what was the investor's holding period return if a total of \$1 per share in dividends was received over the 6 month period?
- 10%
 - 27.1%
 - 17.1%
 - 13.3%

ANS: D

Solution:

$$\text{HPR} = (\$33 - \$30 + \$1) / \$30 = 13.3\%$$

PTS: 1 OBJ: TYPE: E. Prob NAT: Analytic skills
LOC: Understand derivative market TOP: Holding period returns

51. What is the holding period return to an investor who bought 100 shares of Oil Slick stock nine months ago for \$36 per share, received two \$50 dividend checks, and sold the stock today at \$38 a share.
- 5.56%
 - 8.33%
 - 11.11%
 - 6.94%

ANS: B

Solution:

$$(\$38 + \$1 - \$36) / \$36 = 0.0833 \text{ or } 8.33\%$$

PTS: 1 OBJ: TYPE: E. Prob NAT: Analytic skills
LOC: Understand derivative market TOP: Holding period returns

52. If a treasury bond can be purchased for \$9,450 today and the bond holder will receive \$850 in interest and the \$10,000 face value at maturity, what is the percentage holding period return?
- 14.8%
 - 5.8%
 - 6.7%
 - 12.6%

ANS: A

Solution:

$$(\$10,000 - \$9,450 + \$850) / \$9,450 = 0.148 \text{ or } 14.8\%$$

PTS: 1 OBJ: TYPE: E. Prob NAT: Analytic skills
LOC: Knowledge of financial analysis and cash flows TOP: Holding period returns

53. You bought 100 shares of Risky Venture stock six months ago for \$14 per share and sold it yesterday for \$12. The company paid a total of \$0.24 per share in dividends to you during the time you held the stock. What was your holding period return?
- 25.14%
 - 16.67%
 - 12.57%
 - 16.00%

ANS: C

Solution:

$$\text{HPR} = (\$12 - \$14 + \$0.24) / \$14 = -0.1257 \text{ or } -12.57\%$$

PTS: 1 OBJ: TYPE: E. Prob NAT: Analytic skills
LOC: Knowledge of financial analysis and cash flows TOP: Holding period returns

54. Maher purchased 100 shares of Chill Pill Pharmaceuticals at \$30 per share last spring and sold them in six months for \$36 per share. The stock paid no dividend. What was Maher's holding period return?
- 40%
 - 20%
 - 10%
 - 5%

ANS: B

Solution:

$$\text{HPR} = (3600 - 3000)/3000 \times 100\% = 20\%$$

PTS: 1

OBJ: TYPE: E. Prob

NAT: Analytic skills

LOC: Knowledge of financial analysis and cash flows

TOP: Holding period returns

55. Two years ago you bought 100 shares of Big Bubba convertible preferred stock at \$25 per share. The preferred stock had an annual dividend of \$2.125 per share, and a total of \$3.19 in dividends per share have been paid so far. Today the company announced that the stock is redeemable for \$26.70 plus accrued and unpaid dividends, for a total of \$27.76. Alternatively, holders may convert their shares of preferred stock at a conversion rate of 1.6393 shares of Big Bubba common stock for each share of preferred stock. If the closing price of Big Bubba common stock is \$27.50, what is your holding period return?
- 93.08%
 - 23.80%
 - 80.32%
 - 64.60%

ANS: A

Solution:

$$\text{Ending price} = \$27.50(1.6393) = \$45.08$$

$$\text{HPR} = (\$45.08 - \$25 + \$3.19)/\$25 = 0.9308 \text{ or } 93.08\%$$

PTS: 1

OBJ: TYPE: C. Prob

NAT: Analytic skills

LOC: Knowledge of financial analysis and cash flows

TOP: Holding period returns

56. If the spot rate (in U.S. dollars) for Japanese Yen is 0.00703 and the 180 day forward rate is 0.00717, then the Yen is trading at an annualized
- premium of 4.04%
 - premium of 3.98%
 - premium of 3.91%
 - discount of 3.89%

ANS: B

Solution:

$$\text{Premium} = [(0.00717 - 0.00703)/0.00703](12/6) = 0.0398$$

PTS: 1

OBJ: TYPE: C. Prob

NAT: Analytic skills

LOC: Understand derivative skills

TOP: Foreign currency value over time

57. Lear purchased 100 shares of Quitcha Twitchin Anti-inch Cream stock at \$30 per share last year and sold them eleven months later for \$24 per share. The shares split 2 for 1 shortly after Lear purchased the stock. If the stock paid \$0.25 per share in dividends last year, what is Lear's holding period return?
- 61.67%
 - 19.17%
 - 21.67%
 - 6.17%

ANS: A

Solution:

$$\text{HPR} = [2400 - 1500 + .25(100)]/1500 \times 100\% = 61.67\%$$

PTS: 1

OBJ: TYPE: C. Prob

NAT: Analytic skills

LOC: Understand derivative market

TOP: Holding period returns

58. All of the following reflect the implications of income taxes for financial managers EXCEPT:
- Interest payments on debt made by the firm are not tax deductible.
 - Preferred stock and common stock dividends are not tax deductible.
 - Dividends are taxed on the corporate level as profits and are taxed on the stockholders' tax return as income.
 - Depreciation provides a tax deduction for the corporation.

ANS: A PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function
TOP: Income taxes and financial management

59. All of the following are financial intermediaries EXCEPT:
- commercial banks
 - investment companies
 - thrift institutions
 - loan sharks

ANS: D PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function
TOP: Overview of the US financial system

60. Which of the following is correct regarding the forms of market efficiency?
- I. In an efficient capital market stock prices provide an unbiased estimate of the true value of an enterprise.*
- II. In an efficient capital market, stock prices reflect the present value of the firm's expected cash flows.*
- I only
 - II only
 - Both I and II
 - Neither I nor II

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function TOP: Market efficiency

61. There are three forms of market efficiency. All of the following statements are correct EXCEPT:
- The weak form efficiency states that no investor can earn excess returns based on historical price information.
 - The strong form of efficiency states that no investor can consistently earn excess returns since all public and private information is reflected in stock prices.
 - The semi-strong form of efficiency states that no investor can earn excess returns based on an investment strategy using public information.
 - Market efficiency is a hard and fast rule that has been verified in real-world situations.

ANS: D PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function TOP: Market efficiency

62. Which of the following statements is/are correct about financial intermediaries?
- I. Financial intermediaries primarily operate within the secondary market.*
- II. Examples of financial intermediaries are: commercial banks, thrift companies and the internal revenue service.*
- I only
 - II only
 - Both I and II
 - Neither I nor II

ANS: D PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function
TOP: Overview of the US financial system

63. There are highly publicized hedge fund problems, for example Julian Robertson's Tiger fund or Long Term Capital Management. The impact that this has had on hedge funds is:
- minimal. They have continued to grow in size and number.
 - huge. Hedge funds are being discontinued.
 - being felt in the overall reallocation of hedge funds into bonds.
 - inconsequential and irrelevant. Investors may rely on the due diligence of the fund managers.

ANS: A PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function
TOP: Introduction: Finance Challenge

64. An example of a financial middleman is a:
- commercial bank
 - stock broker
 - insurance company
 - thrift institution

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function
TOP: An overview of the U.S. financial system

65. An example of a listed security exchange within the secondary market is:
- OTC
 - NYSE
 - NASDAQ
 - Automated quotations

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function
TOP: Security exchanges and Stock market indexes

66. As a group, net savers are:
- businesses
 - households
 - government
 - partnerships

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates
TOP: An overview of the U.S. financial system

67. Trading on the NYSE is conducted by members of the exchange. The members that execute orders and act as agents on behalf of their clients are::
- Floor Brokers
 - Exchange Runners
 - Designated Market Makers
 - SEC Agents

ANS: A PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates

TOP: Security exchanges and Stock market indexes

68. The difference between the bid price and the ask price on a security is the:
- spread
 - value
 - asset factor
 - commission

ANS: A PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates
TOP: Security exchanges and Stock market indexes

69. There are many reasons why there was a financial crisis in 2007. The most significant event closely associated with this crisis is:
- the stock market crash
 - the real estate bubble
 - government overspending
 - the use of financial hedging

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Knowledge of financial markets and interest rates
TOP: Overview of the Financial Crisis of 2007-2010

70. In the financial crisis of 2007 there was cheap money coming from emerging markets. Examples of emerging markets are all of the following EXCEPT:
- South Korea
 - Australia
 - India
 - China

ANS: B PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand derivative market TOP: Overview of the Financial Crisis of 2007-2010

71. Although there was a financial crisis in 2007-2010, some firms were able to weather the crisis. These firms had all of the following characteristics which were directly responsible for their ability to survive the crisis EXCEPT:
- Tight control over fixed and variable costs
 - Low business risk
 - A business model which encouraged risk taking by management that paid off
 - Low product pricing

ANS: C PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function in the enterprise
TOP: Overview of the Financial Crisis of 2007-2010

ESSAY

1. What are the differences between the primary and secondary markets?

ANS:

The primary market allows the investor to purchase new securities. Net proceeds from such sales go to the issuing corporation.

The secondary market allows the investor to purchase securities that are already in circulation. These are purchased through an organized security exchange, for example NYSE, or in the over-the-counter market, and none of the proceeds go to the issuing corporation.

PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function TOP: Financial markets

2. What is the purpose and importance of the stock market indexes?

ANS:

Stock market indexes give a broad indication of how the stock market or a segment of it performed during a particular day. The most known index is the Dow Jones Industrial Average (DJIA), which is composed of 30 stocks. The index gives an overview of how well stocks are doing, the overall health of the economy, and the anticipated marketability of securities.

PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function TOP: Stock market indexes

3. Explain the degrees of market efficiency and their applicability to the stock market.

ANS:

1. Weak form market efficiency: No investor can earn excess returns based on historical price information or past return information.
2. Semi-strong market efficiency: No investor can earn excess returns based on an investment strategy using any public information. Stock prices consistently incorporate any new information about the stock or the issuing company.
3. Strong market efficiency: No investor can consistently earn excess returns based on any public or private information. Stock prices reflect all information, both public and private.

The number of investors who have traded with insider knowledge provides graphic evidence that the strong form efficiency does not hold.

PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function TOP: Market efficiency

4. Define the differences between the capital market and the money market. Give examples of the kinds of securities found in each category.

ANS:

Money market securities are short-term and liquid with maturities under one year. There is minimal risk in the money market and money market securities generally pay interest that is guaranteed. Types of money market securities are: cash and cash equivalents, commercial paper, treasury bills, government securities, and certificates of deposit.

Capital market securities are long-term and illiquid with maturities greater than one year. There is significant risk involved and capital market securities earn a rate of return that is not guaranteed. Types of capital market securities are: preferred stocks, common stocks and bonds.

PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking
LOC: Understand the role of the finance function TOP: Financial markets

5. List the types of disclosure forms required by the SEC and explain what information is contained in each form.

ANS:

The various SEC forms listed in the text are:

1. 10-K. This is the firm's annual report to the SEC required from firms with publicly held securities.
2. 10-Q. This form contains quarterly information which updates the 10-K.
3. 14-A filing or Proxy Statement. This form is submitted prior to annual shareholder meetings detailing matters to be discussed and voted upon by the stockholders.

PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking

LOC: Knowledge of the role of the finance function and analysis using public information

TOP: Regulation of the Security Markets

6. List changes that have occurred within financial markets regulation as a result of the passage of the Sarbanes-Oxley Act of 2002.

ANS:

The significant changes that have occurred are:

1. Top management is directly responsible for the accuracy of their firm's financial statements. They must personally certify to the accuracy of the financial statements and internal control systems.
2. The act strengthens the independence and accountability of the audit committee of the firm's internal control system.
3. The act creates the Public Company Accounting Standards Board to oversee the auditing industry to improve the independence and credibility of auditors and the auditing function.
4. The act requires that auditors now certify a firm's financial control system and report any material weaknesses.
5. The act creates structural separation between financial analysts and investment bankers working for the same firm.
6. The act institutes new rules to ensure independence of financial analysts.

PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking

LOC: Knowledge of financial markets and interest rates

TOP: Regulation of the Security Markets

7. How did the mortgage market provide the impetus for the financial crisis of 2007-2010?

ANS:

Mortgage markets in the US evolved to take advantage of easy money flowing in from around the world. Mortgages became securitized. Banks, in the past, were very cautious with regard to who they lent to and ensured that borrowers had sufficient income and collateral to repay their loans to the bank. Beginning in 1980, this changed. Banks and mortgage brokers and lenders would originate the loans and then resell them to other financial institutions. These institutions would bundle the mortgages into a mortgage-backed security or bond and sell them to investors around the world. These bonds were perceived to be very safe. But in the early 2000's the demand exceeded the supply and investment banks found a way to expand supply by reaching into more risky mortgages (known as subprime). As long as real estate prices were going up and the economy and employment levels were high, these derivative securities enjoyed a great deal of popularity and the default risk on these bonds was very low. The increase in home prices was unsustainable and in the end the owners of these derivatives suffered huge losses. There arose fear of lending money between banks which eventually led to a liquidity crisis which resulted in banks and financial institutions being liquidated or taken over by a stronger financial institution.

PTS: 1 OBJ: TYPE: Fact NAT: Reflective thinking

LOC: Understand derivative market TOP: Overview of the Financial Crisis of 2007-2010