6.01 Market Organization And Structure

Question 1
A hedge fund will commit $15 million to a short sale of an exchange-listed stock. The fund sells short the maximum number of shares allowable when the margin requirement is 0.4. The relevant information is shown in the table below:

Share price at initial sale	$30
Share price at repurchase	$28
Dividend (paid 8 months after short sale)	$1/share
Margin loan rate	9%
Broker's deposit rate	4%

No interest is paid for the borrowed shares, but there is a short rebate on the sales proceeds. If the fund closes out the position in exactly 1 year, the total percentage return is *closest* to:
A. 8.3%
B. 18.3%
C. 26.7%

Question 2
Which of the following financial intermediaries is *least likely* to provide liquidity to the markets they operate in?
A. Dealers
B. Brokers
C. Mortgage banks

Question 3
When a retail investor transacts with a broker-dealer in a well-developed financial market, the investor would *most appropriately* be concerned with:
A. liquidity.
B. conflicts of interest.
C. regulatory oversight.

Question 4
A broker concerned with executing a trade in a timely manner and with a high probability of execution would *most appropriately* use a(n):
A. limit order.
B. market order.
C. immediate or cancel order.

Question 5
An investor believes in the long-term prospects of a volatile growth stock and buys shares at USD 40. If the investor wants to protect against potential losses, which of the following is the *most appropriate* market order?
A. Good-till-canceled sell, limit USD 35
B. Good-till-canceled sell, stop USD 35
C. Good-till-canceled short sale, limit USD 35

Question 6
A publicly listed company needs to raise equity capital. The company contacts existing institutional shareholders to gauge interest. Six mutual funds and two pension funds participate and buy all the shares offered. This offering is *most likely* a:
A. rights offering.
B. private placement.
C. secondary market transaction.

Question 7
A trader buys a company's stock on margin and sells it after one year, with the following relevant information:

Shares purchased	100
Purchase price	$45
Sale price	$60
Dividend	$1
Commission (per share, on both purchases and sales)	$0.05
Margin requirement	50%

Ignoring interest costs, and assuming dividends were paid on the sale date, the return on the transaction is *closest* to:
A. 36%
B. 67%
C. 71%

Question 8
Investors participating in a rights offering *most likely* have the opportunity to:
A. purchase rights from the issuer.
B. sell their shares back to the company.
C. buy new shares below the market price.

Question 9
Which of the following statements concerning market orders is *most* accurate?
A. Market orders typically seek the best price throughout the day.
B. Market orders typically have a lower chance of executing than limit orders.
C. Market orders are more likely to cause price concessions than limit orders.

Question 10
A bank allows employees to give investment advice without being registered. A market regulator investigating this matter is *most likely* concerned about:
A. preventing insider trading.
B. setting and maintaining standards.
C. ensuring compliance with employment laws.

Question 11
.An investor has $12,000 cash to invest and wants to establish a short position on stock valued at $50. If the initial margin requirement is 60%, the maximum number of shares the investor can sell short is *closest* to:
A. 240
B. 400
C. 600

Question 12
If a fund's investment policy statement limits the fund to investing only in securities, which of the following is *least likely* to be in the fund's portfolio?
A. Bond futures contracts
B. Gold exchange-traded funds (ETFs)
C. Common stock trading over the counter

Question 13
Which of the following is *least likely* considered a primary market transaction?
A. A company issues common stock via an IPO.
B. A company issues common stock via a secondary offering.
C. A company repurchases its own outstanding common stock.

Question 14
The financial markets of a country are characterized by easy access to market information, low transaction costs, and fewer financial products than in most countries. This country's financial markets are *best* described as:
A. operationally efficient, informationally efficient, and complete.
B. operationally efficient, informationally efficient, but not complete.
C. informationally efficient and complete, but not operationally efficient.

Question 15
A silver producer negotiates an agreement to deliver a specific amount of silver ore to a local ore processor for a specified price in six months. This arrangement is *most appropriately* done with which type of contract?
A. Futures
B. Options
C. Forward

Question 16
A risk manager is considering the difference between futures and forward contracts. Compared with futures contracts, forward contracts *most likely*:
A. are standardized.
B. use daily settlement.
C. involve more counterparty risk.

Question 17
A company will receive Singaporean dollars (SGD) in 45 days and immediately convert it to Australian dollars (AUD) on receipt. To hedge the currency risk, which of the following positions is *most appropriate* for this company?
A. Sell SGD at the spot rate 45 days from today.
B. Take a long position in the SGD forward today.
C. Take a short position in the SGD forward today.

Question 18
Of the following, the *most likely* distinction between an open-end fund and a closed-end fund is:
A. closed-end funds can be redeemed by the fund.
B. open-end funds are sold back to the fund by the investor.
C. closed-end funds usually trade at the fund's net asset value.

Question 19
A market's limit order book for a stock is listed below:

Bid size	Price (CNY)	Offer Size
400	171.80	
600	171.90	
500	172.00	
200	172.20	
	172.35	700
	172.40	100
	172.60	300
	172.85	500

If a buy limit order for 100 shares is entered and is said to "make the market," its limit price is *most likely*:
A. CNY 172.20
B. CNY 172.30
C. CNY 172.35

Question 20
A trader buys a European call option on a stock for €2, with a strike price of €60, when the stock is trading at €58. Assuming no transaction costs, the trader should exercise the option only if, on the day of expiry, the price of the underlying stock is:
A. below €60.
B. above €60.
C. above €62.

Question 21
An investor places a buy-stop, all-or-nothing order for a security. The type of instruction(s) relating to this order is (are) *best* described as:
A. validity instructions only.
B. execution instructions only.
C. both validity and execution instructions.

Question 22
A market's order book for a stock is listed below:

Bid size	Price (AUD)	Offer size
900	39.00	
200	39.40	
400	39.77	
200	39.85	
	40.05	200
	40.09	300
	40.27	100
	40.50	800

Near the end of a trading day, an investor submits a day order to buy 1,000 shares, limit AUD 40.30. No new bids or offers are submitted before the market closes. Which of the following is *most likely* to occur?
A. The order is completely filled.
B. The order expires after the investor buys 600 shares.
C. The order expires without the investor buying any shares.

Question 23
Which of the following is (are) *most likely* an example(s) of a primary market transaction?

A. Only a private placement
B. Only a seasoned offering
C. Both a private placement and a seasoned offering

Question 24
A client instructs a broker to submit a limit order to buy 10,000 shares of a stock at £15 a share. This is *best* described as a(n):
A. validity instruction.
B. clearing instruction.
C. execution instruction.

Question 25
Which of the following *best* describes a quote-driven market?
A. Dealers and customers trade at dealer bid or ask prices
B. Customer buy and sell orders are matched based on price and time precedence
C. Brokers search for willing counterparties on behalf of customers seeking to buy or sell

Question 26
An investor buys 100 shares of stock at $78. To limit potential losses, the investor places a "good-till-canceled, stop $72, limit $70" sell order. Later that day, after the market closes, the company announces disappointing financial results. The next day, the stock opens at $69. At this point, the investor's loss is *closest* to:
A. $600
B. $800
C. $900

Question 27
In an order-driven market system, the following buy limit orders for a stock are listed in the system's limit book:

Order	Time Arrived	Number of Shares	Limit Price ($)	Special Instructions
1	10:05	100	15.10	Iceberg order (total order is for 200 shares)
2	10:07	200	15.10	
3	10:08	200	15.11	

Each order is listed for 200 shares. Based on the commonly used order precedence hierarchy, if the current market price is $15.10 and the exchange receives a market sell order for 500 shares, then the orders *most likely* to be fully executed are:

A. Orders 1 and 2.
B. Orders 2 and 3.
C. Orders 1, 2, and 3.

Question 28
Which of the following is *most likely* a characteristic of an order-driven market?
A. Participants directly trade with dealers.
B. Exchanges use trading rules to match buyers with sellers.
C. Brokers arrange transactions between buyers and sellers.

Question 29
The primary distinction between money markets and capital markets is *most likely* that:
A. money market securities have greater risk.
B. capital market securities are all debt instruments.
C. money market securities mature within a year or less.

Question 30
An investor bought 100 shares of stock for $50 per share on 80% margin and paid a $20 commission. The call money rate on the margin loan is 10% per annum. The stock pays an annual dividend of $1 per share. The investor sells the shares a year later for $60 per share and pays a $20 commission. The investor's rate of return for the year is *closest* to:
A. 23.88%
B. 24.00%
C. 24.12%

Question 31
A trader has BRL 20,000 and wants to buy on margin to obtain a large stock position. If the local brokerage firm has an initial margin requirement of 0.25, then the maximum total value of stocks that can be purchased is *closest* to:
A. BRL 26,667
B. BRL 60,000
C. BRL 80,000

Question 32
All else equal, if trading liquidity increases in a secondary market, then the effective cost of issuing capital in the primary market will *most likely*:
A. decrease.
B. remain the same.
C. increase.

Question 33
A hedge fund manager conducts extensive fundamental analysis on a company. Based on this analysis, the manager believes an upcoming earnings report will disappoint market

expectations. The manager plans to profit from this situation by taking a short position in the company's stock. In this decision, the manager is *best* described as a(n):
A. hedger.
B. pure investor.
C. information-motivated trader.

Question 34
A leveraged security position is held with only the minimum required equity. If the minimum equity requirement is reduced, the *most likely* consequence is that the position's risk is:
A. increased since the securities are less valuable collateral for the margin loan.
B. decreased since the maximum possible loss is reduced by having less equity in the position.
C. increased since any security price changes will be a larger percentage of the position's equity.

Question 35
An investor is able to subscribe for 100 shares of new-issue stock at a fixed price of $25 per share as a result of already owning 1,000 shares. This transaction is *best* described as a:
A. rights offering.
B. private placement.
C. preferred stock offering.

Question 36
Which of the following is *least likely* a reason for a public company to issue securities through a private placement?
A. Lower issuance costs
B. Higher offering prices
C. Fewer disclosure requirements

Question 37
A trader bought 1,000 shares of a non-dividend paying stock on margin for £100 per share. The trader sells the shares 3 months later for £110 per share. The leverage ratio at the time of the purchase was 3. Ignoring interest on the borrowed amount and transaction costs, the rate of return earned by the trader during this period is *closest* to:
A. 10%
B. 14%
C. 30%

Question 38
A limit order book contains the following information for a stock:

Bid Size	Price	Ask Size
6,000	15.20	
10,000	15.22	
8,000	15.25	
	15.27	6,000
	15.30	10,000
	15.33	12,000

The market bid-ask quote is *most likely*:
A. 15.20 bid, 15.27 ask
B. 15.20 bid, 15.33 ask
C. 15.25 bid, 15.27 ask

Question 39
An investor bought 500 shares of stock on margin at the beginning of the year and sold them all at year-end:

Per Share Data €	
Purchase price	50.00
Sales price	45.00
Dividend	2.00
Commission	0.02

Assume that dividends and interest are paid at year-end. If the leverage ratio is 4 and the call money rate is 6%, then the investor's total rate of return over this period is *closest* to:
A. −42.09%
B. −42.25%
C. −42.32%

Question 40
A trader buys shares of a stock on margin:

Shares purchased	1,000
Purchase price	€700
Leverage ratio	1.25
Maintenance margin	0.40

Based on this information, the margin call price is *closest* to:
A. €233.33
B. €350.00
C. €420.00

Question 41
An individual financial adviser manages the discretionary account of a client who needs both long-term and short-term liquidity and has a low risk tolerance. The advisor is authorized by the client to trade for the account and is paid on a commission basis. In this scenario, a regulatory agency charged with monitoring the activities of financial advisers is *most likely* concerned with:
A. ensuring economic justice.
B. guaranteeing client objectives.
C. controlling an agency problem.

Question 42
An employee of a manufacturing firm is tasked with trading derivatives on behalf of the company. These transactions should limit loss due to price changes of raw materials used in the company's manufacturing process. As an ancillary result of this activity, the employee may occasionally make an unintended additional trading profit for the company. The employee is *best* described as a:
A. long-term investor.
B. professional hedger.
C. market data–driven trader.

Question 43
A market's limit order book for a stock is listed below:

Bid Size (Shares)	Price (EUR)	Offer Size (Shares)
500	102.60	
300	102.80	
200	103.00	
	103.05	150
	103.10	300
	103.20	600

A buy limit order for 200 shares makes a new market when it is priced at:
A. 103.00
B. 103.03
C. 103.05

Question 44
A trader buys 1,000 shares of a stock at $40 per share and deposits a 40% margin. The stock's price subsequently appreciates to $52 per share. The interest charged on the margin loan during the period is $442. Based on only this information, the position's leverage ratio after the price change is *closest* to:
A. 1.85
B. 1.89
C. 3.25

Question 45
If a broker receives a day order from a client, this instruction is *best* described as a(n):
A. validity instruction.
B. clearing instruction.
C. execution instruction.

Question 46
A company that mainly transacts in EUR will have to pay a supplier in USD in 30 days. To hedge currency risk, which of the following actions is *most appropriate* for this company?
A. Take a long position in the USD futures today.
B. Take a short position in the USD futures today.
C. Buy the USD at the spot rate 30 days from today.

Question 47
In contrast to brokers, dealers *most likely*:
A. match buyers to sellers.
B. act as agents for clients.
C. trade directly with clients.

Question 48
An investor buys 5,000 shares of a stock for $25 per share, on 40% margin. If the maintenance margin requirement is 20%, then the investor will receive a margin call at a price *closest* to:
A. $18.75
B. $20.00
C. $25.00

Question 49
A market's limit order book for a stock is listed below:

Bid size	Price (CNY)	Offer Size
900	73.40	
600	73.60	
300	73.75	
400	73.80	
	73.95	100
	74.00	700
	74.07	300
	74.20	800

If a sell limit order for 600 shares is entered and is "inside the market," its limit price is *most likely*:
A. CNY 73.80
B. CNY 73.90
C. CNY 73.95

Question 50
An investor uses ¥90,000 equity to purchase 100 shares of a stock at a leverage ratio of 2.5. If the maintenance margin is 25%, then the trigger price for a margin call (in ¥) is *closest* to:
A. 800
B. 1,688
C. 1,800

Question 51
If a firm provides market liquidity simultaneously to buyers and sellers of the same instrument in different markets, the firm is *best* described as a(n):
A. broker.
B. dealer.
C. arbitrageur.

Question 52
For an investor wanting to make a long-term bullish bet on gold, which of the following is the *best* reason to go long on a futures contract rather than buying physical gold?
A. Gold futures are more liquid than physical gold.
B. Gold futures have less price risk than physical gold.
C. The return on gold futures is not impacted by storage costs.

Question 53
A market's limit order book for a stock is listed below:

Bid size	Price (NZD)	Offer size
500	15.00	
300	15.40	
100	15.45	
300	15.50	
	15.65	200
	15.69	100
	15.77	400
	15.90	900

An investor submits a day order to sell 1,000 shares, limit NZD 15.40. No new bids or offers are submitted before the market closes. The average trade price is *closest* to:
A. 15.40
B. 15.45
C. 15.49

Question 54
An investor buys 2,000 shares of a stock at $21 per share and deposits an initial margin of 40% of the purchase. If the maintenance margin is 25%, the trigger price for a margin call is *closest* to:
A. $13.13
B. $16.80
C. $17.85

Question 55
If dealers provide liquidity in a market, the market is *most likely* a(n):
A. brokered market.
B. order-driven market.
C. quote-driven market.