

Chapter 1 Quiz: An Overview of Financial Markets and Institutions

The questions in this quiz are graded according to difficulty and your score will reflect this.

1

Difficulty: ★ ★ ★

If the financial system is working properly,

- ☐ interest rates are always low
- ☐ risk is always low
- ☐ all necessary projects are funded
- ☐ only projects with high risk-adjusted returns are funded
- ☐ household wealth increases

2

Difficulty: ★ ★ ★

Which of the following is *not* one of the four groups of economic units?

- ☐ households
- ☐ depository institutions
- ☐ business firms
- ☐ governments
- ☐ foreign investors

3

Difficulty: ★ ★ ★

The principal SSUs in the economy are

- ☐ households

- ☐ financial institutions
- ☐ business firms
- ☐ governments
- ☐ foreign investors

4

Difficulty: ★ ★ ★

“Direct financing” means that

- ☐ no financial institutions are involved
- ☐ SSUs borrow directly from DSUs
- ☐ no financial markets are involved
- ☐ DSUs borrow directly from SSUs
- ☐ investment banks lend directly to other financial institutions

5

Difficulty: ★ ★ ★

For investment banks, a major consequence of the 2008 financial crisis was that

- ☐ they were all forced out of business
- ☐ they were prohibited from participating in mortgage markets
- ☐ they were forced to acquire failed depository institutions
- ☐ they were prohibited from offering trading or brokerage services
- ☐ they became subject to strict Federal Reserve oversight

6

Difficulty: ★ ★ ★

A DSU obtains the most direct and predictable financial benefit by

- ☐ trading financial claims in a secondary market

- ☐ issuing financial claims in a primary market
- ☐ acquiring financial assets in a primary market
- ☐ trading financial assets in a secondary market
- ☐ trading financial assets in a primary market

7

Difficulty: ★ ★ ★

Public and private markets differ significantly in all the following except

- ☐ regulation
- ☐ marketability of securities
- ☐ types of costs incurred by participants
- ☐ pricing mechanism
- ☐ ultimate purpose

8

Difficulty: ★ ★ ★

Money and capital markets differ significantly in all the following except

- ☐ importance of financial institutions
- ☐ types of financial claims
- ☐ motives of participants
- ☐ importance to the economy
- ☐ ultimate purpose

9

Difficulty: ★ ★ ★

An important difference between indirect finance and direct finance is that

- ☐ indirect finance requires a financial intermediary
- ☐ direct finance requires a financial intermediary
- ☐ direct finance “re-packages” securities
- ☐ one is much riskier than the other
- ☐ the DSU takes different risks

10

Difficulty: ★ ★ ★

To understand why financial intermediaries exist, we need to understand the role of

- ☐ adverse selection and moral hazard
- ☐ supply and demand
- ☐ transactions costs and information costs
- ☐ debt and equity
- ☐ risk and return

11

Difficulty: ★ ★ ★

Asymmetric information problems occur in two forms:

- ☐ information costs and bargaining costs
- ☐ adverse selection and moral hazard
- ☐ systematic risk and unsystematic risk
- ☐ monetary costs and opportunity costs
- ☐ market failure and transaction failure

12

Difficulty: ★ ★ ★

The five basic intermediation services do *not* include

- ☐ Liquidity

- ☐ Maturity flexibility
- ☐ Currency transformation
- ☐ Indemnification
- ☐ Denomination Divisibility

13

Difficulty: ★ ★ ★

Which of the following is least like all the others?

- ☐ Commercial bank
- ☐ Finance company
- ☐ Savings & loan association
- ☐ Credit union
- ☐ Mutual savings bank

14

Difficulty: ★ ★ ★

A financial institution which fails even though it is profitable over the long run has probably mismanaged

- ☐ credit risk
- ☐ interest rate risk
- ☐ liquidity risk
- ☐ foreign exchange risk
- ☐ political risk

15

Difficulty: ★ ★ ★

The two fundamental reasons for heavily regulating the financial system are

- ☐ protecting consumers and stabilizing the financial system

- ☐ stabilizing inflation and stabilizing interest rates
 - ☐ promoting exports and protecting consumers
 - ☐ strengthening the currency and stabilizing price levels
 - ☐ promoting liquidity and eliminating risk
-

Chapter 8 Quiz: BOND MARKETS

The questions in this quiz are graded according to difficulty and your score will reflect this.

1

Difficulty: ★ ★ ★

Firms issue securities in the capital markets in order to

- ☐ hedge against falling interest rates
- ☐ finance capital goods
- ☐ earn liquidity premiums
- ☐ avoid taxes

2

Difficulty: ★ ★ ★

STRIPS are useful for

- ☐ sheltering interest income from taxation
- ☐ managing default risk
- ☐ immunizing portfolios against interest rate risk
- ☐ eliminating inflation risk

3

Difficulty: ★ ★ ★

The municipal bond market is unique among the capital markets because it has

- ☐ so many issuers
- ☐ such light volume
- ☐ so much risk
- ☐ so few participants

4

Difficulty: ★ ★ ★

A “serial” bond issue involves a range of

- ☐ coupon rates
- ☐ maturity dates
- ☐ par values
- ☐ collateral

5

Difficulty: ★ ★ ★

The yield curve for AAA-rated municipal bonds should plot

- ☐ above that of U.S. Treasuries but below that of AAA-rated corporate bonds
- ☐ below that of U.S. Treasuries but above that of AAA-rated corporate bonds
- ☐ above that of both U.S. Treasuries and AAA corporates
- ☐ below that of both U.S. Treasuries and AAA corporates

6

Difficulty: ★ ★ ★

A “debenture” is a bond which

- ☐ has a floating coupon rate
- ☐ is payable to any bearer
- ☐ is payable to the registered holder
- ☐ is not secured by the pledge of any assets

7

Difficulty: ★ ★ ★

A firm that issues bonds without either a sinking fund or a call provision

- ☐ will probably pay a lower coupon rate
- ☐ probably expects interest rates to fall over the long term
- ☐ probably expects interest rates to rise over the long term
- ☐ probably expects its stock price to fall

8

Difficulty: ★ ★ ★

Bonds issued by an S&P 500 firm will tend to be

- ☐ more marketable but less risky than its common stock
- ☐ more risky but less marketable than its common stock
- ☐ more risky and more marketable than its common stock
- ☐ less risky and less marketable than its common stock

9

Difficulty: ★ ★ ★

Compared to similar non-guaranteed securities, guaranteed securities tend to

- ☐ pay higher yields but be less marketable
- ☐ pay lower yields but be more marketable
- ☐ pay lower yields and be less marketable

- ☐ pay higher yields and be more marketable

10

Difficulty: ★★ ★

“Tranches” are a *not* a way of

- ☐ allocating different levels of risk to different groups of investors
- ☐ allocating different levels of return to different groups of investors
- ☐ allocating the income from a securitized pool of assets
- ☐ diversifying the holdings of a securitized pool of assets

11

Difficulty: ★ ★★

Which regulator is not part of government?

- ☐ NASD
- ☐ SEC
- ☐ Federal Reserve
- ☐ These are all part of government

12

Difficulty: ★★ ★

Which type of bond is never denominated in U.S. dollars?

- ☐ Eurobond
- ☐ Yankee bond
- ☐ Samurai bond
- ☐ junk bond

13

Difficulty: ★ ★ ★

A firm will rarely have an international credit rating higher than that of its home country because

- ☐ national governments are inherently creditworthy
- ☐ of country risk
- ☐ of foreign exchange risk
- ☐ of interest rate risk

14

Difficulty: ★ ★ ★

Yield differences among debt instruments with different credit ratings are called

- ☐ arbitrage
- ☐ credit spreads
- ☐ liquidity premiums
- ☐ anomalies

15

Difficulty: ★ ★ ★

If credit ratings are correct,

- ☐ credit spreads must always be volatile
 - ☐ credit spreads must always be constant
 - ☐ credit spreads must always be narrow
 - ☐ credit spreads must always be positive
-

Chapter 10 Quiz: Equity Markets

The questions in this quiz are graded according to difficulty and your score will reflect this.

1

Difficulty: ★ ★ ★

The most distinguishing feature of common stock is that it

- ☐ pays dividends
- ☐ carries limited liability
- ☐ is the residual claim against the firm's cash flows or assets
- ☐ trades on an organized exchange

2

Difficulty: ★ ★ ★

“Nonparticipating” means that

- ☐ preferred shareholders do not vote
- ☐ the preferred stock dividend is fixed
- ☐ preferred shareholders share the “residual claim”
- ☐ shareholders do not direct day-to-day activities

3

Difficulty: ★ ★ ★

“IPO” stands for

- ☐ Investor Preferred Option
- ☐ Internally Profitable Operations
- ☐ Initial Public Offering
- ☐ Initial Private Offering

4

Difficulty: ★★☆☆

Which is *not* a primary market transaction?

- ☐ IBM buys back 5% of its outstanding common stock
- ☐ Goldman Sachs underwrites a seasoned offering of Boeing common stock
- ☐ Coca Cola privately places \$1 billion of preferred stock with Berkshire Hathaway
- ☐ GE issues \$2 billion of “shelf-registered” securities

5

Difficulty: ★★☆☆

If corporation splits its common stock 3 for 1, which of the following will change?

- ☐ market capitalization
- ☐ earnings per share
- ☐ book value
- ☐ net income

6

Difficulty: ★★☆☆

As between NASDAQ and the NYSE,

- ☐ The NYSE lists more companies with smaller average market capitalization
- ☐ NASDAQ lists more companies with larger average market capitalization
- ☐ The NYSE lists more companies with larger average market capitalization
- ☐ NASDAQ lists more companies with smaller average market capitalization

7

Difficulty: ★ ★ ★

Because NASDAQ is a “dealer market”, bid-ask spreads will likely be

- ☐ negligible
- ☐ low but material in relation to traded value
- ☐ high in relation to traded value
- ☐ difficult to measure

8

Difficulty: ★ ★ ★

Because NYSE has transitioned into a “hybrid market”,

- ☐ “specialists” will probably become less important
- ☐ “specialists” will probably become more important
- ☐ most securities traded on NYSE will be convertible
- ☐ trading costs should rise

9

Difficulty: ★ ★ ★

“ADRs” are a way for

- ☐ foreign investors to buy U.S. stocks on foreign exchanges
- ☐ U.S. investors to buy foreign stocks on U.S. exchanges
- ☐ U.S. investors to buy foreign stocks on foreign exchanges
- ☐ U.S. firms to tap foreign equity markets

10

Difficulty: ★ ★ ★

Which type of order can only apply to a position the investor already holds?

- ☐ short sale
- ☐ market
- ☐ stop loss
- ☐ limit

11

Difficulty: ★ ★ ★

The main laws regulating securities trading in the U.S. date from

- ☐ 1933 and 1934
- ☐ 1863 and 1913
- ☐ 1971 and 1987
- ☐ 2007 and 2008

12

Difficulty: ★ ★ ★

As between bonds and common stock issued by the same firm, the present value calculation should differ noticeably in all the following except

- ☐ discount rate
- ☐ certainty of inputs
- ☐ maturity or time horizon
- ☐ mathematical techniques involved

13

Difficulty: ★ ★ ★

Two widely traded stocks pay identical dividends expected to grow at identical rates. One is “aggressive”; the other is “defensive”. The present value of the dividend stream should be

- ☐ higher for the aggressive stock and lower for the defensive one

- ☐ higher for the defensive stock and lower for the aggressive one
- ☐ the same for both
- ☐ need more information

14

Difficulty: ★ ★ ★

By market capitalization, the largest U.S. stock index is the

- ☐ DJIA
- ☐ S&P 500
- ☐ Russell 2000
- ☐ Wilshire 5000

15

Difficulty: ★ ★ ★

As a predictor of economic activity, the stock market is

- ☐ not at all reliable
- ☐ completely reliable
- ☐ occasionally reliable
- ☐ irrelevant

Chapter 6: The Structure of Interest Rates

The questions in this quiz are graded according to difficulty and your score will reflect this.

1

Difficulty: ★ ★ ★

U.S. Treasury securities are ideal for constructing yield curves because

- ☐ they have different terms to maturity but similar risk and marketability

- ☐ they have different levels of marketability but similar maturities
- ☐ they are denominated in U.S. dollars
- ☐ they price differently than other debt securities

2

Difficulty: ★ ★ ★

Descending yield curves usually occur at or near

- ☐ the end of the year
- ☐ the beginning of a recession
- ☐ the end of a recession
- ☐ equilibrium

3

Difficulty: ★ ★ ★

Suppose the current 1-year rate is 2 percent. The market expects the 1-year rate to be 3 percent 1 year from now, and 5 percent 2 years from now. According to the term structure formula, the current 3-year rate should be

- ☐ 10.000%
- ☐ 10.313%
- ☐ 3.326%
- ☐ 3.333%

4

Difficulty: ★ ★ ★

Suppose the 1-year spot rate is 1% and the 4-year spot rate is 3%. The implied forward rate on a 3-year security of the same risk class originating 1 year from now is

- ☐ 2.313%

- ☐ 3.676%
- ☐ 4.166%
- ☐ 3.767%

5

Difficulty: ★ ★ ★

The actual yield curve is usually more upward sloping than the one predicted by expectation theory because

- ☐ interest rate forecasts are usually wrong
- ☐ investors are indifferent between short maturities and long maturities
- ☐ shorter-term securities are more volatile
- ☐ investors usually demand a liquidity premium on longer-term securities

6

Difficulty: ★ ★ ★

The two theories of term structure in most direct conflict with each other are

- ☐ market segmentation and expectation
- ☐ preferred habitat and market segmentation
- ☐ expectation and preferred habitat
- ☐ preferred habitat and loanable funds

7

Difficulty: ★ ★ ★

Suppose a U.S Treasury note with 10 years to maturity yields 2 percent. An XYZ Corporation Bond with the same term to maturity yields 3 percent. Most of the difference is probably because of

- ☐ liquidity premium
- ☐ interest rate risk

- ☐ default risk
- ☐ purchasing power risk

8

Difficulty: ★ ★ ★

Suppose an AAA-rated municipal bond yields 4% and an AAA-rated corporate bond with the same maturity yields 5%. An investor should prefer the municipal bond if her

- ☐ marginal tax rate exceeds 20%
- ☐ effective tax rate exceeds 20%
- ☐ marginal tax rate exceeds her effective tax rate
- ☐ effective tax rate exceeds her marginal tax rate

9

Difficulty: ★ ★ ★

Marketability is often gauged by

- ☐ the volatility of a security's price
- ☐ the volatility of a security's yield
- ☐ the volume of a security's secondary market
- ☐ the credit rating attached to a security

10

Difficulty: ★ ★ ★

All else equal, callable bonds pay a higher yield because

- ☐ they usually carry higher default risk
- ☐ the call option implies an expectation that interest rates will rise
- ☐ the call option implies an expectation that bond prices will fall
- ☐ the call option increases the bondholder's reinvestment risk

11

Difficulty: ★ ★ ★

The value of a put option on a fixed-coupon bond should vary

- ☐ inversely with interest rates
- ☐ directly with interest rates
- ☐ directly with bond price
- ☐ inversely with maturity

12

Difficulty: ★ ★ ★

The value of a conversion option on a fixed –coupon should vary directly with all the following except

- ☐ price of the stock into which the bond is convertible
- ☐ price of the bond
- ☐ yield to maturity on the bond
- ☐ interest rates

13

Difficulty: ★ ★ ★

The real rate of interest has historically averaged about

- ☐ the same as historic average inflation
- ☐ the same as investment-grade bond yields
- ☐ the same as Treasury yields
- ☐ 3 percent

14

Difficulty: ★ ★ ★

Nominal rates tend to vary directly (or positively) with all the

following except

- ☐ growth of GDP
- ☐ inflation rates
- ☐ growth of the money supply
- ☐ the real rate

15

Difficulty: ★ ★ ★

Over time, interest rates are dominated by

- ☐ cyclical forces
- ☐ seasonal forces
- ☐ government policy
- ☐ productivity

Chapter 3 Quiz: The Fed and Interest Rates

The questions in this quiz are graded according to difficulty and your score will reflect this.

1

Difficulty: ★ ★ ★

Which of the following is *not* a component of M2?

- ☐ savings deposits
- ☐ money market deposits
- ☐ Eurodollars
- ☐ Treasury bills
- ☐ small time deposits

2

Difficulty: ★ ★ ★

The Fed wanted the ability to pay interest on reserves in order to

- ☐ deal with a technical issue of monetary policy during times of low interest rates
- ☐ bail out troubled banks
- ☐ promote increased bank lending
- ☐ limit the supply of reserves
- ☐ prevent inflation

3

Difficulty: ★★ ★

The Fed may influence the Fed Funds Rate in all the following ways *except*

- ☐ buying on the open market
- ☐ selling on the open market
- ☐ exercising its regulatory power over interest rates
- ☐ adjusting the discount rate
- ☐ adjusting reserve requirements

4

Difficulty: ★ ★ ★

The main reason the Fed changes the monetary base is to affect

- ☐ fiscal policy
- ☐ bank profits
- ☐ foreign exchange
- ☐ stock prices
- ☐ the level of output in the economy

5

Difficulty: ★★ ★

An “expansionary” fiscal policy would likely include

- ☐ tax increases
- ☐ budget deficits
- ☐ lowering the Discount Rate
- ☐ budget surpluses
- ☐ increasing reserve requirements

6

Difficulty: ★★ ★

Paying interest on reserves is probably most helpful toward which goal of monetary policy?

- ☐ price stability
- ☐ full employment
- ☐ economic growth
- ☐ stability of the financial system
- ☐ stability of foreign exchange markets

7

Difficulty: ★ ★ ★

Inflation is defined as

- ☐ an increase in GDP
- ☐ an continuous rise in the average price level
- ☐ an increase in the monetary base
- ☐ an increase in the money supply
- ☐ an increase in interest rates

8

Difficulty: ★★ ★

An increase in the money supply should ultimately cause

- ☐ higher business investment and higher household borrowing
- ☐ lower business investment and higher exports
- ☐ lower household borrowing and lower exports
- ☐ lower business investment and higher household spending
- ☐ higher business investment and lower exports

9

Difficulty: ★ ★ ★

“Real” GDP growth occurs when

- ☐ the monetary base increases
- ☐ the price of goods and services increases
- ☐ the quantity of goods and services increases
- ☐ the money supply increases
- ☐ interest rates decrease

10

Difficulty: ★ ★ ★

The proportion of GDP to M1 is an example of

- ☐ inflation
- ☐ real growth
- ☐ nominal growth
- ☐ velocity of money
- ☐ deflation

11

Difficulty: ★ ★ ★

The aftermath of the 2008 financial crisis included

- ☐ record high interest rates
- ☐ the largest bankruptcy in history
- ☐ the largest bank failure in history
- ☐ both the largest bankruptcy and the largest bank failure in U.S. history
- ☐ soaring housing prices

12

Difficulty: ★★☆☆

Which was *not* a direct contributor to the growth of “subprime” mortgage lending?

- ☐ Deposit insurance
- ☐ Housing boom
- ☐ Deregulation
- ☐ Relaxed credit standards
- ☐ Securitization

13

Difficulty: ★☆☆☆

The Federal Government eased regulation of “Fannie Mae” and “Freddie Mac” in order to

- ☐ boost revenue
- ☐ increase home ownership
- ☐ reduce interest rates
- ☐ reduce competition in the financial system
- ☐ fight inflation

14

Difficulty: ★☆☆☆

Credit ratings on mortgage-backed securities were in many cases flawed because

- ☐ the rating agencies were corrupt
- ☐ sufficient data was not available
- ☐ the agencies' mathematical models underestimated default risk
- ☐ there were too many securities
- ☐ they ignored interest rate risk

15

Difficulty: ★ ★ ★

“TARP” stands for

- ☐ Tiered Amortization Refinancing Protocol
- ☐ Tranches Anticipating Repayment
- ☐ Technical Arbitrage Regression Program
- ☐ Treasury Annuity Refunding Portfolio