

Question #1 of 201

Question ID: 606941

All of the following are functions of the Federal Reserve EXCEPT:

- ☐ A) acting as fiscal agent for the U.S. Treasury.
- ☐ B) setting reserve requirements for banks.
- ☒ C) setting initial margin requirements on exempt securities.
- ☐ D) setting the discount rate.

Explanation

The Federal Reserve does not have jurisdiction to set margin for exempt securities. FINRA rules mandate these requirements.

Reference: 14.2.1.2 in the License Exam Manual

Question #2 of 201

Question ID: 606961

If the yield curve becomes inverted, a likely cause would be that the Fed has:

- ☒ A) tightened short-term credit.
- ☐ B) loosened short-term credit.
- ☐ C) loosened long-term credit.
- ☐ D) tightened long-term credit.

Explanation

The Fed's influence on rates is primarily on the short end of the yield curve. Both the discount rate, which it sets, and the federal funds rate, which it influences, are short-term rates. The Fed tightens short-term credit when the economy appears to be overheating. To slow things down, the Fed raises short-term rates to extremely high levels.

Reference: 14.2.1.2.2 in the License Exam Manual

Question #3 of 201

Question ID: 606976

When the U.S. dollar appreciates, which of the following statements are TRUE?

- I. Imports become more competitive with U.S. domestic goods.
- II. Imports become less competitive with U.S. domestic goods.
- III. U.S. exports become more competitive in foreign markets.
- IV. U.S. exports become less competitive in foreign markets.

- ☐ A) II and IV.
- ☐ B) II and III.
- ☒ C) I and IV.
- ☐ D) I and III.

Explanation

When the U.S. dollar appreciates against foreign currency, foreign money buys fewer U.S. goods. As a result, U.S. exports to foreign countries go down, but imports go up because U.S. dollars will buy more foreign goods.

Reference: 14.3.1.1 in the License Exam Manual

Question #4 of 201

Question ID: 607025

Which of the following stocks would NOT be considered a defensive security?

- X **A)** Utility company.
- X **B)** Brewery company.
- X **C)** Tobacco.
- ✓ **D)** Steel company.

Explanation

Steel securities are cyclical and therefore are not considered defensive. Tobacco, alcohol, and utilities are defensive securities because they are not affected by the business cycle.

Reference: 14.5.1.1 in the License Exam Manual

Question #5 of 201

Question ID: 606932

The economic theory that says economic growth results from lower tax rates and lower government spending is:

- X **A)** demand-side theory.
- X **B)** monetary theory.
- X **C)** Keynesian theory.
- ✓ **D)** supply-side theory.

Explanation

Supply-side economics is the theory of Arthur Laffer, who believed that heavy taxing and government intervention have a negative effect on the economy.

Reference: 14.1.2.3 in the License Exam Manual

Question #6 of 201

Question ID: 606913

Which of the following fundamental analysis theories might rely on lowering and raising taxes to stimulate or cool down an economy?

- X **A)** Supply side.
- X **B)** Short interest.
- ✓ **C)** Keynesian.
- X **D)** Breakout.

Explanation

Keynesian theory is interventionist. Supply side theory calls for low taxes and low government spending. Both short interest and breakout theories are technical rather than fundamental analysis theories.

Reference: 14.1.2.1 in the License Exam Manual

Question #7 of 201

Question ID: 607039

The working capital of a corporation includes all of the following EXCEPT:

- X **A)** marketable securities of other companies.
- X **B)** cash.
- X **C)** accounts receivable.
- ✓ **D)** convertible bonds.

Explanation

The working capital of a corporation is equal to its current assets minus its current liabilities. A current liability is payable within 12 months. Because convertible bonds are long-term (not short-term) liabilities, they are not included as working capital.

Reference: 14.6.1.3.5 in the License Exam Manual

Question #8 of 201

Question ID: 606978

Disintermediation is *most* likely to occur when:

- ✓ **A)** money is tight.
- X **B)** the interest ceilings on certificates of deposit have been raised.
- X **C)** interest rates are low.
- X **D)** margin requirements are high.

Explanation

Disintermediation is the flow of deposits out of banks and savings and loans into alternative, higher paying investments. It occurs when money is tight and interest rates are high because these alternative investments may then offer higher yields than S&Ls and banks.

Reference: 14.3.0.3 in the License Exam Manual

Question #9 of 201

Question ID: 606989

All of the following actions will increase the deficit in the U.S. balance of payments EXCEPT:

- X **A)** U.S. foreign aid.
- ✓ **B)** purchase by foreigners of U.S. securities.
- X **C)** investments by U.S. firms abroad.
- X **D)** Americans buying Japanese cars.

Explanation

A debit in the U.S. balance of payments occurs when the country pays out more abroad than it takes in. This occurs when the U.S. imports more than it exports, invests money abroad, or sends money to foreign countries in the form of foreign aid.

Reference: 14.3.1.1 in the License Exam Manual

Question #10 of 201

Question ID: 607076

A fund is investing capital raised from both institutional and private investors in a nonpublic company to assist the company with an anticipated acquisition. This type of investment would be known as

- ✓ **A)** private equity
- X **B)** a nonqualified plan
- X **C)** selling away
- X **D)** a general partnership

Explanation

Private equity is equity capital invested in operating companies that are not publicly traded. The investment of capital can be made to aid or assist the company in a number of ways, including, but not limited to, making acquisitions; strengthening the company's balance sheet; or turning around a distressed company.

Reference: 14.6.2.9 in the License Exam Manual

Question #11 of 201

Question ID: 606945

To tighten credit during inflationary periods, the Federal Reserve Board can take any of the following actions EXCEPT:

- X **A)** to raise reserve requirements.
- ✓ **B)** to lower taxes.
- X **C)** to sell securities in the open market.
- X **D)** to increase the amount of U.S. government debt held by primary dealers.

Explanation

To curb inflation, the Fed can sell securities in the open market, thus changing the amount of U.S. government debt institutions hold. It can also raise the reserve requirements, discount rate, or margin requirements. The Fed has no control over taxes, which are changed by Congress.

Reference: 14.2.1.2 in the License Exam Manual

Question #12 of 201

Question ID: 607093

Growth companies tend to have all of the following characteristics EXCEPT:

- X **A)** potential investment return from capital gains rather than income.
- X **B)** low dividend payout ratios.
- ✓ **C)** low PE ratios.
- X **D)** high earnings retention ratio.

Explanation

Growth companies have high PE ratios and a low dividend payout ratio because they retain most if not all of their earnings. Investors anticipating fast growth bid up prices so PE ratios tend to be high. Growth companies retain most of their earnings to fund future growth. Investors select growth companies for capital gain potential, not for investment income.

Reference: 14.7.3.6 in the License Exam Manual

Question #13 of 201

Question ID: 606949

Which of the following tools is *most* often used by the Federal Reserve Board to control the money supply?

- X **A)** Changing margin requirements.
- X **B)** Altering the reserve requirements.
- ✓ **C)** Engaging in open market operations.
- X **D)** Lowering the discount rate.

Explanation

The Federal Reserve Board has 3 tools to influence the money supply: the discount rate, the reserve requirement, and open market operations. The purchase and sale of government securities by the Federal Open Market Committee (FOMC) is the most frequently used tool of the Fed.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #14 of 201

Question ID: 606957

In its efforts to control the money supply, the Board of Governors of the Federal Reserve System has a number of tools at its disposal. The one used *most* frequently is:

- X **A)** changing the discount rate.
- ✓ **B)** open market transactions by the FOMC.
- X **C)** changing the reserve requirements.
- X **D)** adjusting margin requirements.

Explanation

The Federal Open Market Committee (FOMC) meets every 6 weeks. The other actions are taken as needed, sometimes less than once per year.

Reference: 14.2.1.2.1. in the License Exam Manual

Question #15 of 201

Question ID: 607024

Which of the following is a defensive stock?

- X **A)** Airline company stocks.
- ✓ **B)** Utility company stocks.

- X **C)** Steel company stocks.
- X **D)** Food company debentures.

Explanation

Utility companies are going to generate revenue no matter what the economy does. Therefore, they are considered defensive in the face of a bad economy.

Reference: 14.5.1.1 in the License Exam Manual

Question #16 of 201

Question ID: 606935

The Conference Board releases information about the economy on a periodic basis. Included are a number of different indicators. These indicators can be used to predict how the economy as a whole might change. Which of the following would be considered a leading indicator?

- X **A)** Corporate profits.
- ✓ **B)** Stock prices as measured by a broad index such as the S&P 500.
- X **C)** Gross domestic product.
- X **D)** Industrial production.

Explanation

The stock market, which anticipates economy activity, is a leading economic indicator. GDP and industrial production are coincident, or current, economic indicators. Corporate profits are a lagging indicator.

Reference: 14.1.1.3.1 in the License Exam Manual

Question #17 of 201

Question ID: 606954

If the U.S. economy shows signs of slowing, the Federal Reserve might:

- ✓ **A)** purchase securities in open market operations.
- X **B)** increase the discount rate.
- X **C)** increase the reserve requirement.
- X **D)** sell securities in open market operations.

Explanation

To counter a slowing economy, the Fed would probably try to inject liquidity into the economy by purchasing U.S. government securities from primary dealers in a repurchase arrangement. The other choices would tend to tighten liquidity.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #18 of 201

Question ID: 607105

ABC Investors Group is looking to do a leveraged buyout of the XYZ Corporation. Which of the following would be the *most* likely source of capital to fund this takeover?

- X **A)** ABC's liquid assets.
- ✓ **B)** A long-term bank loan.
- X **C)** XYZ's creditors.
- X **D)** XYZ's liquid assets.

Explanation

The word "leverage" generally implies the use of borrowed money. The acquiring company will either issue a bond or borrow from a bank and use that money to fund the acquisition. In most cases, the assets of the target company are used as collateral for the loan.

Reference: 14.7.1.1 in the License Exam Manual

Question #19 of 201

Question ID: 606985

Which of the following risks would be of least concern to someone purchasing common shares of a foreign company?

- ☐ A) Political risk
- ☐ B) Currency risk
- ☐ C) Market risk
- ☒ D) Interest rate risk

Explanation

All common stock investments entail market risk. Political risk is the risk that the country of origin for the investment will experience economic or social turmoil, putting the investment in jeopardy. All foreign investments involve currency exchange risk. Interest rate risk, however, is more generally associated with debt instrument investments.

Reference: 14.3.1 in the License Exam Manual

Question #20 of 201

Question ID: 607046

A customer buys XYZ stock at \$60 per share. The stock is currently trading at a 10:1 price-to-earnings (PE) ratio. The firm declares a 3:1 stock split. What will the PE ratio be after the split if earnings remain unchanged?

- ☐ A) 5:1.
- ☐ B) 12:1.
- ☐ C) 3:1.
- ☒ D) 10:1.

Explanation

If earnings remain unchanged, the PE ratio remains the same, 10:1. Earnings are currently \$6 per share ($\$60 / 10$). After a 3:1 split, each share will be valued at \$20. If earnings are unchanged, the same \$6 of earnings is now applicable to 3 shares or \$2 per share. Price divided by earnings equals PE ratio ($\$20 / \$2 = 10:1$ PE ratio).

Reference: 14.6.2.6 in the License Exam Manual

Question #21 of 201

Question ID: 606982

All of the following could account for the dollar falling in value against the yen EXCEPT:

- ☒ A) a severe political crisis in Japan.
- ☐ B) the Fed selling dollars in the interbank market.
- ☐ C) a worsening trade deficit with Japan.
- ☐ D) the Fed buying yen in the interbank market.

Explanation

A severe political crisis in Japan would have a negative effect on the value of the yen versus the dollar. The other choices would have a positive effect on the relative value of the yen.

Reference: 14.3.1.1 in the License Exam Manual

Question #22 of 201

Question ID: 606924

A recession is defined as a drop in GDP for:

- ☒ A) 2 consecutive quarters.
- ☐ B) 4 consecutive quarters.
- ☐ C) 3 consecutive quarters.
- ☐ D) 6 consecutive quarters.

Explanation

A recession is a drop in GDP for 2 consecutive quarters.

Question #23 of 201

Question ID: 607063

A highly leveraged company has the smallest percentage of its total capitalization in:

- ☐ A) long-term debt.
- ☒ B) common stock.
- ☐ C) short-term debt.
- ☐ D) preferred stock.

Explanation

Common stock, which represents ownership, would account for the smallest amount of capitalization of a highly leveraged company. Highly leveraged companies have the largest amount of their capitalization in debt instruments. Preferred stock, although an equity, is more like a debt instrument because of the stated dividend rate.

Reference: 14.6.2.8 in the License Exam Manual

Question #24 of 201

Question ID: 606965

The Fed would be inclined to increase the money supply if which of the following were declining?

- I. The Gross National Product.
- II. Unemployment.
- III. Bond yields.
- IV. The Consumer Price Index.

- ☐ A) III and IV.
- ☐ B) I and II.
- ☒ C) I and IV.
- ☐ D) II and III.

Explanation

Increasing the money supply tends to increase business activity through lower interest rates. If the GNP is declining, business is slowing down, and the Fed would want to stimulate the economy by making more money available. If the CPI is declining, inflation is receding, which usually occurs when business is contracting, which the Fed would usually wish to counteract. There is a danger of increased inflation if the Fed is too generous.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #25 of 201

Question ID: 607058

Which of the following describes additional paid-in capital?

- ☐ A) Also called earned surplus.
- ☐ B) Total of all residual claims that stockholders have against the corporation's assets.
- ☐ C) Total of all earnings since a corporation was formed, less dividends.
- ☒ D) The difference between the total dollar amount received from the issuance of common stock and the stock's aggregate par value.

Explanation

Additional paid-in capital is the difference between the dollar amount received from the sale of stock and the stock's aggregate par value. Earned surplus is another name for retained earnings.

Reference: 14.6.1.3.2 in the License Exam Manual

Question #26 of 201

Question ID: 606975

If the value of the U.S. dollar increases with respect to other currencies, it would make:

- I. U.S. exports, like heavy equipment, more competitive in foreign markets.
- II. U.S. exports, like heavy equipment, less competitive in foreign markets.
- III. foreign imports into the United States, such as cars, less competitive in U.S. markets.
- IV. foreign imports into the United States, such as cars, more competitive in U.S. markets.

- ☐ A) I and IV.
- ☒ B) II and IV.
- ☐ C) I and III.
- ☐ D) II and III.

Explanation

When the value of the U.S. dollar rises in relation to other currencies, exported products become more expensive in those foreign markets and are less competitive. On the other hand, imported products become less expensive in U.S. markets and are more competitive.

Reference: 14.3.1.1 in the License Exam Manual

Question #27 of 201

Question ID: 607094

Your client lists an investment objective as being income from dividends. Which of the following would be the least suitable recommendation given that objective?

- ☐ A) Investment in preferred shares
- ☐ B) Investment in utility stocks
- ☐ C) Investment in stocks found in the DJIA
- ☒ D) Investment in a growth company

Explanation

Of the answer choices listed, growth companies would be the least likely to pay dividends. Generally their earnings, if any exist, are put back into the company to help fund growth. All of the others would be more likely to pay dividends.

Reference: 14.7.3.6 in the License Exam Manual

Question #28 of 201

Question ID: 606999

If stock market indexes, such as the S&P 500 and the DJIA, are declining daily, and the number of declining stocks relative to advancing stocks is falling, a technical analyst will conclude that the market is:

- ☒ A) oversold.
- ☐ B) overbought.
- ☐ C) becoming volatile.
- ☐ D) unstable.

Explanation

The momentum of the market decline seems to be easing as the number of decliners to advancers is leveling out. It looks like the advance/decline line is moving in a direction away from decliners. A technical analyst would conclude that the market is oversold and approaching a bottom.

Reference: 14.4.2.3 in the License Exam Manual

Question #29 of 201

Question ID: 607102

ALFA Enterprises pays a quarterly dividend of \$.15 and has earnings per share of \$2.40. What is the dividend payout ratio?

- ☐ A) 14.4%.
- ☐ B) 6.25%.
- ☐ C) 30%.
- ☒ D) 25%.

Explanation

Earnings per share are typically calculated for a year. So the annual dividend of \$.60 ($\$.15 \times 4$) is divided by \$2.40 to calculate what percentage of earnings is paid as a dividend; or rather, the dividend payout ratio ($.60 / 2.40 = 25\%$).

Reference: 14.7.3.5 in the License Exam Manual

Question #30 of 201

Question ID: 607081

You are reviewing a company's financial statements to assist a customer. What kind of information is most likely to be found in the footnotes to those financial statements?

- ✓ **A)** Accounting methods used
- X **B)** The name, address, and contact information for the firm's chief executive officer
- X **C)** The names of the company's most formidable competitors
- X **D)** The length of time each director has served on the board of directors (BOD)

Explanation

Footnotes to a company's financial statements will contain important financial information such as accounting methods used as well as important management philosophy that may impact the company's overall financial health and performance.

Reference: 14.6.4 in the License Exam Manual

Question #31 of 201

Question ID: 606938

The Conference Board releases information about the economy on a monthly basis. Included are a number of different indicators. Economic indicators can be leading, lagging, or coincidental, which indicates the timing of their changes relative to how the economy as a whole changes. New orders for durable goods is what kind of economic indicator?

- ✓ **A)** Leading.
- X **B)** Coincident.
- X **C)** Lagging.
- X **D)** Cotermious.

Explanation

New orders for durable goods are a leading economic indicator.

Reference: 14.1.1.3.1 in the License Exam Manual

Question #32 of 201

Question ID: 606939

Economic analysts are reporting that there is a general rise in prices for consumer goods and a high unemployment rate occurring simultaneously. This can best be described as

- X **A)** deflation
- X **B)** inflation
- ✓ **C)** stagflation
- X **D)** stagnation

Explanation

Stagflation is the term used to describe the unusual combination of inflation (a rise in prices) and high unemployment (stagnation). This generally occurs when the economy isn't growing (there is a lack of consumer demand and business activity), yet prices for goods are still rising.

Reference: 14.1.1.2.5 in the License Exam Manual

Question #33 of 201

Question ID: 607031

The common stock of all of the following corporations is considered defensive stock EXCEPT stock of a(n):

- X **A)** utility.
- X **B)** retail grocery chain.
- X **C)** pharmaceutical company.
- ✓ **D)** airplane manufacturer.

Explanation

Defensive stocks generally have little volatility. Firms that produce nondurable consumer goods (tobacco, food, drugs, energy) are more immune to the business cycles than other industries and are sometimes called defensive industries. This term has nothing to do with the defense industry that supplies the Pentagon with goods and services.

Reference: 14.5.1.1 in the License Exam Manual

Question #34 of 201

Question ID: 606922

Which of the following would be considered a lagging indicator?

- ✓ **A)** Corporate profits.
- X **B)** Housing permits issued.
- X **C)** S&P 500.
- X **D)** Hours worked.

Explanation

Corporate profits are a lagging indicator because profits are reported the quarter after they have been earned. The S&P 500 is a leading indicator because stock prices are based on expectations of future earnings. Housing permits are also leading indicators of future economic activity. The measure of hours worked is a coincident indicator because it reflects current levels of employment.

Reference: 14.1.1.3.3 in the License Exam Manual

Question #35 of 201

Question ID: 607038

All of the following will affect the working capital of a corporation EXCEPT:

- X **A)** an increase in assets.
- X **B)** a decrease in liabilities.
- X **C)** declaration of a cash dividend.
- ✓ **D)** payment of a cash dividend.

Explanation

Working capital is defined as current assets minus current liabilities. Payment of a cash dividend will reduce current assets (cash) and current liabilities (dividend payable) by the same amount, leaving working capital unchanged.

Reference: 14.6.1.3.5 in the License Exam Manual

Question #36 of 201

Question ID: 607066

A company's changing from straight line to accelerated depreciation will:

- I. increase income in the early years.
- II. decrease income in the early years.
- III. increase income in the later years.
- IV. decrease income in the later years.

- X **A)** I and IV.
- X **B)** I and III.
- X **C)** II and IV.
- ✓ **D)** II and III.

Explanation

Accelerated depreciation increases charged expenses during the early years of equipment life but decreases charged expenses during the later years.

Reference: 14.6.1.4.2 in the License Exam Manual

Question #37 of 201

Question ID: 607021

If a chart indicates that both the DJIA and the advance/decline line have been increasing since January, and the advance/decline line continues to rise, the market should:

- ☐ A) turn down moderately.
- ☐ B) turn down sharply.
- ☒ C) continue to rise.
- ☐ D) not change.

Explanation

A rising advance/decline line indicates that more stocks are rising in price than falling; a rising advance/decline line is a bullish indicator.

Reference: 14.4.1.2 in the License Exam Manual

Question #38 of 201

Question ID: 607107

Your customer wants to add 1 or 2 stocks of companies manufacturing household appliances to his portfolio. One of the tools he is using to compare companies to one another is the inventory turnover ratio. He makes all of the following correct statements to you EXCEPT

- ☒ A) the ratio is always higher in industries dealing in durable goods like household appliances
- ☐ B) comparing inventory turnover ratios is just one point of comparison between companies in the same industry
- ☐ C) dissimilar industries would generally have different acceptable norms for this measurement
- ☐ D) the ratio can indicate how efficiently inventory is being handled

Explanation

Higher inventory ratios are generally associated with companies dealing in perishable items. Those industries dealing in durable goods like household appliances are likely to have lower inventory turnover ratios as their norm.

Reference: 14.7.3.7 in the License Exam Manual

Question #39 of 201

Question ID: 606959

If the Federal Reserve Board (FRB) decides that the rate of inflation is too high, which is it *most* likely to do?

- I. Tighten the money supply.
- II. Loosen the money supply.
- III. Lower the discount rate.
- IV. Raise the discount rate.

- ☐ A) II and IV.
- ☐ B) I and III.
- ☒ C) I and IV.
- ☐ D) II and III.

Explanation

If the FRB decides to attempt to curb inflation, it can raise the discount rate which in turn tightens the money supply.

Reference: 14.2.1.2.2 in the License Exam Manual

Question #40 of 201

Question ID: 607052

All of the following are true of stockholders' equity EXCEPT:

- ✓ **A)** that it is carried as an asset on the balance sheet.
- X **B)** that it is reflected in the book value of the stock.
- X **C)** that it consists of stock issued, capital surplus, and retained earnings.
- X **D)** that it is also called net worth.

Explanation

Stockholders' equity or net worth (total assets less liabilities) is what a stockholder is entitled to should a company liquidate.

Reference: 14.6.1.3 in the License Exam Manual

Question #41 of 201

Question ID: 606979

Which organization or governmental unit sets fiscal policy?

- X **A)** Federal Open Market Committee (FOMC).
- ✓ **B)** Congress and the President.
- X **C)** Secretary of the Treasury.
- X **D)** Federal Reserve Board (FRB).

Explanation

Congress and the President set fiscal policy, while the FRB sets monetary policy.

Reference: 14.3 in the License Exam Manual

Question #42 of 201

Question ID: 607077

Speaking to a customer about a private equity fund a registered representative (RR) makes all of the following statements. Which of the following statements regarding private equity funds is NOT true?

- X **A)** Private equity investments can fund the turnaround of a distressed company.
- ✓ **B)** Private equity capital commitments are generally short term and highly liquid from the moment the capital is invested.
- X **C)** Private equity investments can be used to take an existing public company private.
- X **D)** Private equity capital investments are generally considered more suitable for either institutional or accredited investors as opposed to individual investors.

Explanation

Private equity capital can be used for a number of different reasons and is generally capital raised from institutional and accredited investors. Institutional and accredited investors are usually in a better position to commit the larger sums of capital needed for private equity investments and to make the capital commitment for an extended period of time to accommodate the length of time it takes to accomplish the intended goal of the invested capital.

Reference: 14.6.2.9 in the License Exam Manual

Question #43 of 201

Question ID: 721480

A stock pays a \$.50 quarterly dividend. The company had earnings per share last year of \$10. The company's dividend retention ratio is:

- X **A)** 5%.
- X **B)** 20%.
- X **C)** 10%.
- ✓ **D)** 80%.

Explanation

The dividend retention ratio is the reciprocal of the dividend payout ratio. If the company pays a \$2 dividend on earnings of \$10, it pays out 20% of the earnings available to common shareholders in the form of the dividend. That means it retains 80% of the available monies.

Question #44 of 201

Question ID: 607088

XYZ Corporation has a market price of \$45 per share and earnings per share of \$3 when XYZ announces a 3-for-1 split. After the split, the price-to-earnings ratio of XYZ will be:

- ☒ A) 15
- ☐ B) 3
- ☐ C) 45
- ☐ D) 5

Explanation

Before the split, the company had a P/E ratio of 15 (\$45 per share / \$3). After the split, the price per share and the EPS drop in the same proportion, leaving the PE ratio unchanged (new price = \$15, new EPS = \$1).

Reference: 14.7.3.6 in the License Exam Manual

Question #45 of 201

Question ID: 607045

Working capital is:

- ☐ A) only the cash and equivalents.
- ☐ B) current assets - inventory.
- ☐ C) total assets - total liabilities.
- ☒ D) current assets - current liabilities.

Explanation

Current means cash or assets that would be exchanged for cash in the ordinary course of business in the current year. In the case of liabilities, current means maturing or falling due within the current year. The net of current assets less the current liabilities implies the company has cash availability of the remainder with which to work.

Reference: 14.6.1.3.5 in the License Exam Manual

Question #46 of 201

Question ID: 607104

All of the following ratios are measures of the liquidity of a corporation EXCEPT:

- ☐ A) quick ratio.
- ☐ B) acid-test ratio.
- ☐ C) current ratio.
- ☒ D) debt/equity ratio.

Explanation

Liquidity ratios measure a firm's ability to meet its current financial obligations and include the current ratio and acid-test (quick) ratio. However, the debt/equity ratio is a capitalization ratio and measures the amount of leverage compared to equity in a company's overall capital structure.

Reference: 14.7.2 in the License Exam Manual

Question #47 of 201

Question ID: 607068

Which items would change if a company buys equipment for cash?

- I. The working capital.
- II. The total assets.
- III. The total liabilities.
- IV. The shareholders' equity.

- X **A)** IV only.
- X **B)** I and II.
- ✓ **C)** I only.
- X **D)** II and IV.

Explanation

The general balance sheet formula is assets = liabilities + shareholders' equity. A purchase of equipment for cash would affect working capital by reducing current assets. However, it would not affect total assets since it is an exchange of one asset (cash) for another asset of equal value (equipment). Since no loan was needed, it does not affect total liabilities, nor does it affect equity.

Reference: 14.6.1.3.5 in the License Exam Manual

Question #48 of 201

Question ID: 606987

Disintermediation is a movement of funds which could result from all of the following EXCEPT:

- X **A)** the money supply tightens.
- X **B)** the Federal Reserve Board increases reserve requirements.
- X **C)** money market rates are higher than typical savings account rates.
- ✓ **D)** the discount rate is decreased by FRB.

Explanation

Disintermediation is money flowing from banks and thrifts into money market instruments. It tends to occur when money is tight, causing rates to rise and making money funds more attractive than passbook savings rates.

Reference: 14.3.0.3 in the License Exam Manual

Question #49 of 201

Question ID: 606952

To curb excessive economic activity, the Fed would:

- X **A)** decrease discount rate.
- X **B)** sell bonds to the public at auction.
- X **C)** decrease reserve requirements.
- ✓ **D)** sell securities in open market operations.

Explanation

The Federal Open Market Committee can take money out of circulation during inflationary times through the sale of securities to primary dealers.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #50 of 201

Question ID: 606923

Increases in which of the following indicators are regarded as predictors of the level of business activity?

- X **A)** Employment levels.
- X **B)** Personal incomes.
- ✓ **C)** Building permits.
- X **D)** Corporate profits.

Explanation

Increases in building permits are indicative of increased, future business activity and are therefore considered a leading economic indicator. Increases in personal income and employment levels reflect current, not future activity, and would be considered coincident indicators. Corporate profits are lagging economic indicators.

Reference: 14.1.1.3.1 in the License Exam Manual

Question #51 of 201

Question ID: 606998

Which index represents the thinnest selection of stocks?

- ✓ **A)** Dow Jones Industrial Average
- X **B)** S&P 500
- X **C)** Wilshire
- X **D)** Value Line Index

Explanation

Of those listed, the DJIA represents the fewest stocks (30).

Reference: 14.4.3.5 in the License Exam Manual

Question #52 of 201

Question ID: 606929

The Conference Board releases information about the economy on a monthly basis. Included are a number of different indicators. Economic indicators can be leading, lagging, or coincidental, which indicates the timing of their changes relative to how the economy as a whole changes. Which of the following is a lagging economic indicator?

- X **A)** Hours worked.
- ✓ **B)** Corporate profits.
- X **C)** Housing permits issued.
- X **D)** S&P 500.

Explanation

Both the S&P 500 and housing permits are leading economic indicators, as is the measure of hours worked because it reflects changes in the average workweek during the current period of time. Corporate profits are a lagging indicator.

Reference: 14.1.1.3.3 in the License Exam Manual

Question #53 of 201

Question ID: 607013

Proponents of which of the following technical theories assume that small investors are usually wrong?

- X **A)** Breadth of market.
- ✓ **B)** Odd lot.
- X **C)** Volume of trading.
- X **D)** Short interest.

Explanation

Odd lots are usually traded by small investors; some analysts believe small investors are generally wrong.

Reference: 14.4.3.2 in the License Exam Manual

Question #54 of 201

Question ID: 607070

An analyst comparing revenues with expenses is *most* likely analyzing:

- X **A)** working capital.
- X **B)** liquidity.
- X **C)** capitalization.
- ✓ **D)** cash flow.

Explanation

The analyst is most likely measuring the income statement for cash flow (money coming in against money going out). Working capital analysis would involve examining the balance sheet's current assets and current liability entries, not the income statement. Capitalization analysis involves examination of long-term debt and stock issues. Liquidity

analysis involves examining current assets and liabilities from the balance sheet.

Reference: 14.6.3 in the License Exam Manual

Question #55 of 201

Question ID: 606973

The Federal Reserve Board (FRB) has announced actions to increase the money supply. Which of the following would you expect to see increase first?

- I. Pass book savings account rate.
- II. Employment.
- III. Production.
- IV. Corporate profits.

- ☐ A) I and III.
- ☐ B) II and IV.
- ☐ C) I and IV.
- ☒ D) II and III.

Explanation

When the Federal Reserve Board takes actions to increase the money supply, more dollars become available for lending. Of the choices given, an increase in lending would stimulate production and employment first.

Reference: 14.2.1.2.3 in the License Exam Manual

Question #56 of 201

Question ID: 607001

Which of the following investment strategies makes sense for an investor who believes in the efficient market hypothesis (EMH)?

- ☒ A) Investing in a market index fund.
- ☐ B) Investing in actively managed mutual funds.
- ☐ C) Market timing.
- ☐ D) Hedging through the purchase of derivative investments.

Explanation

A market index fund is a favorite strategy of those who believe in the efficient market hypothesis, which holds that all relevant information has already been taken into account by the market, and it is pointless to try to outperform the broader market indexes.

Reference: 14.4.3.5 in the License Exam Manual

Question #57 of 201

Question ID: 607091

Which of the following would *best* describe working capital?

- ☐ A) The amount of money available to the corporation that is currently being held in cash or cash equivalent positions.
- ☐ B) The value per share available to shareholders in the event of bankruptcy.
- ☐ C) A corporation's net worth.
- ☒ D) The amount of money a corporation has available to work with if it liquidates its current assets and pays off all of its current liabilities.

Explanation

Working capital equals current assets minus current liabilities.

Reference: 14.7.2 in the License Exam Manual

Question #58 of 201

Question ID: 606967

If the rate of inflation has slowed down and the Federal Reserve Board (FRB) takes action to spur the economy forward, which of the following statements regarding outstanding fixed-income securities trading in the secondary market as a result of the FRB action is TRUE?

- ☐ A) Their maturities will be extended.
- ☐ B) Their yields will rise.
- ☒ C) Their prices will rise.
- ☐ D) Their coupon rates will rise.

Explanation

To spur the economy forward, the Federal Reserve Board lowers interest rates. Lowering the interest rates causes the prices of outstanding bonds to rise in the secondary market.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #59 of 201

Question ID: 607053

Which of the following balance sheet entries may be affected when a company pays a cash dividend?

- I. Shareholders' equity.
- II. Total assets.
- III. Total liabilities.
- IV. Working capital.

- ☐ A) I and IV.
- ☒ B) II and III.
- ☐ C) I and III.
- ☐ D) II and IV.

Explanation

When a company pays a cash dividend, the dividends payable (a current liability) and the cash account (current assets) are reduced by the same amount. Because liabilities and assets are each reduced by the same amount, working capital is not affected. Shareholders' equity, or net worth, is also not affected when the dividend is paid.

Reference: 14.6.2.5 in the License Exam Manual

Question #60 of 201

Question ID: 607073

Which of the following is defined as profits after taxes and interest paid, less preferred dividends, divided by the number of shares of outstanding common stock?

- ☐ A) Cash flow per share.
- ☐ B) Book value per share.
- ☐ C) Price-earnings (P/E).
- ☒ D) Earnings per share (EPS).

Explanation

Dividing net income after taxes, interest, and payment of preferred dividends by the number of common shares outstanding determines earnings per share (EPS).

Reference: 14.6.3.4 in the License Exam Manual

Question #61 of 201

Question ID: 606986

When investing in a foreign bond fund, a customer will profit if:

- I. the U.S. dollar strengthens.
- II. the U.S. dollar weakens.
- III. foreign currencies strengthen.
- IV. foreign currencies weaken.

- ☐ A) I and III.
- ☐ B) II and IV.

- X **C)** I and IV.
- ✓ **D)** II and III.

Explanation

Since the fund is purchasing bonds denominated in foreign currencies, a weakening of the U.S. dollar or strengthening of foreign currencies will be beneficial.

Reference: 14.3.1 in the License Exam Manual

Question #62 of 201

Question ID: 607079

In analyzing the ability of a company to meet its debt obligations but not wanting to chance that certain accounting decisions or practices will cloud the picture, one measure that you might look at is the firm's

- X **A)** net worth found on the firm's balance sheet
- ✓ **B)** earnings before interest, taxes, depreciation, and amortization (EBITDA), calculated from the firm's income statement
- X **C)** price-to-earnings (P/E) ratio
- X **D)** cash flow found on a cash flow statement

Explanation

Earnings before interest, taxes, depreciation, and amortization (EBITDA), calculated from the firm's income statement, is a metric that measures the ability of a company to repay debt obligations (interest and principal), eliminating accounting decisions and techniques that might not allow for the best assessment.

Reference: 14.6.3.1.2 in the License Exam Manual

Question #63 of 201

Question ID: 607048

Which of the following is NOT affected by the issuance of a bond?

- X **A)** Assets.
- ✓ **B)** Shareholders' equity.
- X **C)** Total liabilities.
- X **D)** Working capital.

Explanation

When bonds are issued, cash is received (thus increasing current assets) and long-term debt increases (increasing total liabilities). Because there is no corresponding increase in current liabilities, working capital increases. There is no effect on shareholders' equity because the increased liability is offset by the asset (cash) received.

Reference: 14.6.2.2 in the License Exam Manual

Question #64 of 201

Question ID: 607020

The largest component of the S&P 500 index is made up of

- ✓ **A)** industrial stocks.
- X **B)** financial stocks.
- X **C)** technology stocks.
- X **D)** small-cap stocks.

Explanation

The S&P 500 index is a weighted index. The index components and weighting have been adjusted over time. While the index consists of large capitalization companies the majority of them historically have been industrial stocks.

Reference: 14.4.3.5 in the License Exam Manual

Question #65 of 201

Question ID: 607082

Financial footnotes found in which of the following would be of the greatest importance to your broker/dealer's retail customers?

- I. The BD's principal approved advertising
- II. Balance sheets of stocks you've recommended to them
- III. Income statements of stocks you've recommended to them
- IV. Your BD's Website page showing the history of the firm

- ✓ **A)** II and III
- X **B)** II and IV
- X **C)** I and III
- X **D)** I and IV

Explanation

While footnotes found anywhere are of importance, those found in financial statements like balance sheets and income statements would be the most important to your BD's customers when evaluating investment recommendations.

Reference: 14.6.4 in the License Exam Manual

Question #66 of 201

Question ID: 606956

The Federal Reserve sets which of the following?

- I. The reserve requirement
- II. The federal funds rate
- III. The prime rate
- IV. Initial margin requirements for nonexempt securities

- ✓ **A)** I and IV
- X **B)** III and IV
- X **C)** I and II
- X **D)** II and III

Explanation

The Fed is responsible for setting the reserve requirement, the discount rate, and the initial margin requirement for nonexempt securities. The federal funds rate, charged in bank-to-bank borrowing, is a market rate of interest. While it is heavily influenced by Fed action, it is not set by the Fed. and neither is the prime rate, which is the rate large banks charge their most creditworthy customers for unsecured loans.

Reference: 14.2.1.2 in the License Exam Manual

Question #67 of 201

Question ID: 607064

Which of the following may be affected when a company buys machinery for cash?

- I. Shareholders' equity.
- II. Current assets.
- III. Total liabilities.
- IV. Working capital.

- X **A)** I and IV.
- X **B)** I and III.
- X **C)** II and III.
- ✓ **D)** II and IV.

Explanation

The purchase of machinery for cash will reduce current assets and working capital.

Reference: 14.6.1.3.5 in the License Exam Manual

Question #68 of 201

Question ID: 606942

The Federal Open Market Committee's (FOMC) open market operations affect all of the following EXCEPT:

- ☐ A) interest rates.
- ☐ B) the amount of money in circulation.
- ☒ C) the national debt.
- ☐ D) bank excess reserves.

Explanation

When the Fed buys and sells securities on the open market, it attempts to expand or contract the amount of money in circulation. When the Fed buys, bank excess reserves go up; when the Fed sells, bank excess reserves go down. This, in turn, affects the money supply, credit, and interest rates. The national debt is affected only when the government issues and redeems treasury securities, not when it trades them in the market.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #69 of 201

Question ID: 606969

If the FOMC sells government securities in the open market, it will:

- ☐ A) increase the money supply.
- ☒ B) decrease the money supply.
- ☐ C) not change the money supply.
- ☐ D) none of these.

Explanation

The selling of government securities in the open market takes dollars out of the money supply and increases short-term interest rates.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #70 of 201

Question ID: 607006

Which of the following events is of the greatest importance to a technical analyst?

- ☒ A) The stock's price recently penetrated its resistance level.
- ☐ B) The issuer's current book value increased.
- ☐ C) Standard & Poor's raised the credit rating of the issuer.
- ☐ D) The company announced the resignation of its chief financial officer.

Explanation

Technical analysts focus on market price patterns. Typically, a technical analyst becomes bullish when a stock's price exceeds its resistance level (it penetrates its former ceiling price). Book values, credit ratings, and the resignation of a company's senior officer are of interest to fundamental analysts.

Reference: 14.4.2.2 in the License Exam Manual

Question #71 of 201

Question ID: 606960

In its attempt to increase the money supply, the Federal Open Market Committee (FOMC) buys T-bills. This action should cause the yield on T-bills to:

- ☐ A) fluctuate.
- ☒ B) decrease.
- ☐ C) stabilize.
- ☐ D) increase.

Explanation

The FOMC purchase is meant to increase the attractiveness (market price) of T-bills. Because the price will be driven up by an increased market demand and a decreased supply, yields should decrease.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #72 of 201

Question ID: 606921

The US gross domestic product (GDP) consists of the annual sum of all goods and services produced within the nation. It includes: personal consumption, private investment, foreign investment, net exports and all

- ☐ A) federal debt.
- ☐ B) Treasury securities issued.
- ☒ C) government purchases.
- ☐ D) wages paid to employees.

Explanation

The gross domestic product includes everything produced in the United States in a year, whether used domestically, shipped abroad, or sold to the government.

Reference: 14.1.1.1 in the License Exam Manual

Question #73 of 201

Question ID: 606936

Statistics from which of the following industries are considered a leading indicator of economic growth?

- ☐ A) High technology.
- ☐ B) Natural gas.
- ☐ C) Automotive.
- ☒ D) New housing.

Explanation

A leading indicator predicts economic trends. Such indicators include steel shipments, stock market indices, manufacturing orders, and housing starts.

Reference: 14.1.1.3.1 in the License Exam Manual

Question #74 of 201

Question ID: 607004

An inverted Head and Shoulders Formation would mean which of the following to a chartist?

- ☐ A) A bull market.
- ☐ B) A bear market.
- ☐ C) A reversal of an uptrend.
- ☒ D) A reversal of a downtrend.

Explanation

Head and Shoulders Formations indicate the reversal of market trends to chartists. An inverted formation would forecast the reversal of a downtrend. A Head and Shoulder's Top Formation would forecast the reversal of an uptrend.

Reference: 14.4.2.1.2 in the License Exam Manual

Question #75 of 201

Question ID: 607083

All of the following are characteristics of business development companies (BDCs) EXCEPT

- ☐ A) BDCs are created to assist small companies while still in the initial stages of development
- ☒ B) all BDCs are fairly liquid and easy to divest of
- ☐ C) BDCs can be listed and traded on exchanges or be nontraded

- ☐ **D)** they allow smaller nonaccredited investors to invest in more speculative startup ventures

Explanation

Business development companies (BDCs), also known as growth development companies, are created to assist small companies while still in the initial stages of development. They allow smaller nonaccredited investors to invest in more speculative startup ventures usually considered more suitable for accredited investors. They can be both listed and traded on US exchanges or nontraded, but with nontraded BDCs illiquidity or the risk of being able to exit the investment easily should be a primary suitability consideration.

Reference: 14.6.2.9.1 in the License Exam Manual

Question #76 of 201

Question ID: 607101

A customer purchased 100 shares of SNP at \$38. At the time of purchase, the PE ratio was 12. Approximately what are the earnings per share of SNP?

- ☐ **A)** \$1.20.
- ☒ **B)** \$3.16.
- ☐ **C)** \$3.80.
- ☐ **D)** \$12.00.

Explanation

The PE ratio is a comparison of the current market price at the close to the earnings of the company. $\$38 \text{ (CMV)} / 12 \text{ (PE ratio)} = \3.16 approximate EPS.

Reference: 14.7.3.1 in the License Exam Manual

Question #77 of 201

Question ID: 607072

Net worth is equal to:

- ☒ **A)** assets minus liabilities.
- ☐ **B)** income minus liabilities.
- ☐ **C)** liabilities minus assets.
- ☐ **D)** liabilities minus income.

Explanation

The balance sheet offers a "snap shot" view of a firm's resources and obligations based on the firm's most recent reporting date. The basic balance sheet equation is: assets – liabilities = net worth.

Reference: 14.6.1.1 in the License Exam Manual

Question #78 of 201

Question ID: 606925

You note that "help wanted" advertisements in "The Wall Street Journal" have been increasing. This economic measure is a:

- ☐ **A)** lagging indicator.
- ☐ **B)** none of these.
- ☐ **C)** coincident indicator.
- ☒ **D)** leading indicator.

Explanation

The number of employment advertisements is viewed as a leading indicator that will predict a change in the economy. The duration of unemployment claims is considered a lagging indicator-a result of a change in the economy.

Reference: 14.1.1.3.1 in the License Exam Manual

Question #79 of 201

Question ID: 607026

If disposable personal income has fallen steadily over the past year, which of the following is *most* likely to be affected?

- ☐ A) Firm that produces nondurable consumer goods.
- ☐ B) Defense industry.
- ☐ C) Tobacco industry.
- ☒ D) Automotive industry.

Explanation

The automobile industry is cyclical and of the choices, the most likely to be affected by a change in the business cycle as indicated by declining personal income.

Reference: 14.5.1.2 in the License Exam Manual

Question #80 of 201

Question ID: 607092

All of the following are liquidity measures EXCEPT:

- ☐ A) current assets divided by current liabilities.
- ☒ B) annual dividends per share divided by EPS.
- ☐ C) current assets minus inventory divided by current liabilities.
- ☐ D) cash equivalents and receivables divided by current liabilities.

Explanation

Liquidity is the ability to convert an asset into cash. All of the options listed are used to measure the liquidity of a company except for the dividend payout ratio which would tell you nothing about liquidity.

Reference: 14.7.2 in the License Exam Manual

Question #81 of 201

Question ID: 607087

Which of the following is the *most* stringent test of liquidity?

- ☒ A) (Cash + cash equivalents) / current liabilities.
- ☐ B) Assets / current liabilities.
- ☐ C) Current assets / current liabilities.
- ☐ D) (Current assets - inventory) / current liabilities.

Explanation

Of the answers given, the cash assets ratio is the most stringent because it excludes inventories and accounts receivable.

Reference: 14.7.2 in the License Exam Manual

Question #82 of 201

Question ID: 607011

One of your customers notices that the short interest on the NYSE is high. When she asks you for an interpretation, you should tell her that this signals a:

- ☐ A) bearish market.
- ☒ B) bullish market.
- ☐ C) period of stability in the market.
- ☐ D) period of volatility in the market.

Explanation

Even though short interest represents the number of shares sold short, many investors consider it a bullish indicator when this number is high. Each share that has been sold short must be replaced (covered) at some point. To replace the stock shorted, an investor must go into the market to buy that stock. When all of those short sellers have to buy back stock they shorted, it puts upward pressure on the prices of those stocks.

Reference: 14.4.3.3 in the License Exam Manual

Question #83 of 201

Question ID: 607036

If the assets of a company did not change, but stockholders' equity declined, it follows that:

- ☐ A) retained earnings increased.
- ☒ B) liabilities increased.
- ☐ C) liabilities declined.
- ☐ D) capital surplus decreased.

Explanation

Stockholders' equity is assets minus liabilities. If assets stay the same, then an increase in liabilities will cause a decline in equity.

Reference: 14.6.1.3 in the License Exam Manual

Question #84 of 201

Question ID: 607095

Under what circumstances will a dilution of equity occur?

- ☐ A) Stock split.
- ☒ B) Conversion of convertible bonds into common stocks.
- ☐ C) Stock dividend.
- ☐ D) Issue of mortgage bonds to replace debentures.

Explanation

Dilution of equity occurs when stockholders experience a reduction in their percentage ownership of the company. If bonds are converted, more common shares are issued and the shareholder's equity is diluted. A stock dividend or stock split does not change a stockholder's percentage of ownership. Refunding debts has no effect on stockholders.

Reference: 14.7.3.2 in the License Exam Manual

Question #85 of 201

Question ID: 606953

The federal funds rate has been decreasing. A likely cause would be:

- ☐ A) heavy borrowing by banks to meet reserve requirements.
- ☐ B) heavy open market sales by the Fed.
- ☒ C) heavy open market purchases by the Fed.
- ☐ D) a low level of noncompetitive bids at the auction.

Explanation

The Fed increases the money supply by buying securities in the open market. This causes interest rates to fall.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #86 of 201

Question ID: 607016

A registered representative is explaining a particular market theory that maintains that the direction of a single stock or any general market is unpredictable. Which theory is he speaking of?

- ☐ A) Dow
- ☒ B) Random walk
- ☐ C) Odd-Lot
- ☐ D) Modern portfolio

Explanation

The random walk theory maintains that the direction of any stock, sector, or market in general is unpredictable. The theory is based on the "efficient market" theory, which holds that the stock market is perfectly efficient with prices reflecting all known information at any given time.

Question #87 of 201

Question ID: 607014

According to the Dow theory, reversal of a primary bullish trend must be confirmed by:

- ☐ A) five consecutive days of upward price trends.
- ☒ B) the Dow Jones Industrial Average and Transportation Average.
- ☐ C) the advance/decline line.
- ☐ D) the duration of the secondary movements.

Explanation

Charted price trends can be deceptive, so a trend must be confirmed by the Dow Jones Industrial Average and Transportation Average.

Reference: 14.4.3.1 in the License Exam Manual

Question #88 of 201

Question ID: 606926

According to Keynesian economic theory, an economy's health can be ensured if the government:

- ☐ A) increases the money supply.
- ☐ B) cuts taxes for businesses and the wealthy.
- ☐ C) does not interfere.
- ☒ D) increases aggregate demand.

Explanation

Keynesians theorize that government efforts to increase aggregate demand by increasing purchases of goods and services result in the healthiest economy. In general, higher taxes and higher government spending lead to favorable economic conditions.

Reference: 14.1.2.1 in the License Exam Manual

Question #89 of 201

Question ID: 606994

According to technical analysis, when the market is consolidating, a chart showing the market trendline appears to be moving:

- ☐ A) downward to reach a new low.
- ☒ B) sideways within a narrow range.
- ☐ C) downward with sporadic upswings.
- ☐ D) upward to reach a new peak.

Explanation

A consolidating market is one that stays within a narrow price range. When viewed on a graph, the trendline is horizontal and is said to be moving sideways, meaning neither up nor down.

Reference: 14.4.2.1.1 in the License Exam Manual

Question #90 of 201

Question ID: 606958

An increase in the Federal Reserve Board's (FRB) reserve requirement has which of the following effects on total bank deposits?

- I. Decrease.
- II. Increase.
- III. Multiplier effect.
- IV. Logarithmic effect.

- ☐ A) II and IV.

- ✓ **B)** I and III.
- X **C)** I and IV.
- X **D)** II and III.

Explanation

If the FRB raises the reserve requirement, total bank deposits decrease, with the overall impact being increased because of the multiplier effect. If banks must meet a higher reserve requirement, they will have less money available to lend.

Reference: 14.2.1.2.3 in the License Exam Manual

Question #91 of 201

Question ID: 606951

The immediate effect of the Federal Reserve's buying and selling of securities in the marketplace is to:

- ✓ **A)** make credit more or less available.
- X **B)** set reserve requirements for Fed. member banks.
- X **C)** check inflation.
- X **D)** stop a recession.

Explanation

The immediate effect is to make credit more or less available. The long-term effect is to check inflation or to create a situation in which the economy can recover from a recession.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #92 of 201

Question ID: 721478

In order to control the money supply, the Federal Reserve Bank (FRB) has a number of tools available to it. Which of the following tools does it employ?

- ✓ **A)** The discount rate, reserve requirements for member banks, and open market operations
- X **B)** The federal funds rate, setting the consumer price index, and the discount rate
- X **C)** The discount rate, open market operations, and the federal funds rate
- X **D)** Setting the gross domestic product, the discount rate, and reserve requirements for member banks

Explanation

To affect control over the money supply, the tools available to the FRB are setting the discount rate, setting reserve requirements for Federal Reserve member banks, and open market operations (buying and selling T-bills in the open market). The federal funds rate, while influenced by the FRB, is not set by it and the consumer price index and the gross domestic product are measurements of the economy not rates or tools utilized to impact the money supply.

Reference: 14.2.1.2 in the License Exam Manual

Question #93 of 201

Question ID: 607044

A profitable company distributes 70% of its earnings in the form of cash dividends. What is the effect on the balance sheet of the 30% earnings NOT distributed?

- X **A)** A decrease to capital surplus.
- ✓ **B)** An increase to retained earnings.
- X **C)** A decrease to retained earnings.
- X **D)** An increase to capital surplus.

Explanation

Capital surplus comes from original investors. Retained earnings are created by undistributed company profits.

Reference: 14.6.1.3.3 in the License Exam Manual

Question #94 of 201

Question ID: 607023

A defensive issue would NOT include companies producing:

- X **A)** tobacco products.
- X **B)** foodstuff.
- X **C)** clothing.
- ✓ **D)** building materials.

Explanation

Food, clothing, and tobacco will be bought during every phase of a business cycle; however, building materials will not usually be purchased in poor economic times. Thus, these types of items (food, clothing, and tobacco) are said to be defensive because they should suffer much less loss in bad economic times.

Reference: 14.5.1.1 in the License Exam Manual

Question #95 of 201

Question ID: 606955

Which of the following are methods used to manage the economy?

- I. Modern portfolio theory.
- II. Monetary policy.
- III. Fiscal policy.
- IV. Efficient market theory.

- X **A)** I and III.
- ✓ **B)** II and III.
- X **C)** I and IV.
- X **D)** III and IV.

Explanation

Fiscal and monetary policies are two methods used to manage the nation's economic activity.

Reference: 14.2.1 in the License Exam Manual

Question #96 of 201

Question ID: 606946

The Federal Reserve Board foresees the probability of an overheated economy and the resumption of double-digit inflation. Therefore, the FRB takes actions to slow down the economy, including increasing the discount rate. Which of the following are likely effects of these moves?

- I. An increase in the prime rate.
- II. An increase in bond yields and an accompanying decrease in bond prices.
- III. A slowdown in corporate growth.
- IV. A decrease in corporate earnings.

- X **A)** III and IV.
- X **B)** I and II.
- X **C)** I, III and IV.
- ✓ **D)** I, II, III and IV.

Explanation

The FRB attempts to slow down the economy and decrease the money supply with a corresponding increase in interest rates. When interest rates rise, the prime rate increases, bond yields rise, and bond prices drop. Higher interest rates have a tendency to slow down corporate growth, with a resulting slowdown in earnings; these events occur in this approximate sequence.

Reference: 14.2.1.2.2 in the License Exam Manual

Question #97 of 201

Question ID: 607059

KPT, Inc. is preparing to report its net income for the past year. An increase in which of the following causes a decrease in the reported net income?

- I. Tax rate.
- II. Cash dividend.
- III. Allowance for bad debts.
- IV. Retained earnings.

- X **A)** II and III.
- X **B)** II and IV.
- ✓ **C)** I and III.
- X **D)** I and II.

Explanation

Higher taxes mean less net income. The allowance for bad debts is an expense item; increasing it lowers operating income. Dividends are paid out of retained earnings which have no effect on the net income the company reports.

Reference: 14.6.1.2.2 in the License Exam Manual

Question #98 of 201

Question ID: 606972

The Federal Reserve Board can manage the money supply with all the following tools EXCEPT:

- X **A)** discount rate.
- ✓ **B)** income tax rate.
- X **C)** open market operations.
- X **D)** bank reserve requirements.

Explanation

The Federal Reserve Board uses several tools to manage the money supply, including bank reserve requirements, open market operations (trading government securities), and the discount rate. Income tax rates are set by Congress.

Reference: 14.2.1.2 in the License Exam Manual

Question #99 of 201

Question ID: 606995

The value of the Dow Jones Composite average would be *most* affected by a change in the value of which of the following market sectors?

- X **A)** Transportation.
- X **B)** Utility.
- X **C)** Growth.
- ✓ **D)** Industrial.

Explanation

The Dow Jones Composite Average consists of 65 stocks: 30 industrial, 20 transportation, and 15 utilities issues. Because industrials are the largest component, changes in their prices have the greatest effect on the averages.

Reference: 14.4.3.5 in the License Exam Manual

Question #100 of 201

Question ID: 607003

A technical analyst would be *most* interested in which of the following?

- X **A)** PE ratios.
- ✓ **B)** 200-day moving averages.
- X **C)** Quick ratios.
- X **D)** Working capital.

Explanation

Technical analysts try to predict the market by examining price and volume trends. They expect the market will act in the future as it has in the past. Technical analysts are not interested in the fundamental aspects of a company, such as its financial statement ratios.

Reference: 14.4.2 in the License Exam Manual

Question #101 of 201

Question ID: 607019

Which of the following would be of *least* interest to a technical analyst?

- ✓ **A)** PE ratio.
- X **B)** Advance/decline line.
- X **C)** Trading volume.
- X **D)** Short interest ratio.

Explanation

Technical analysts rely on price and trading trends to determine when to buy or sell stock. They are not interested in the specific financial information of an issuer; PE ratios are of greater interest to fundamental analysts.

Reference: 14.4 in the License Exam Manual

Question #102 of 201

Question ID: 607060

An improvement in economic conditions is indicated by an increase in all of the following EXCEPT:

- X **A)** consumer orders.
- ✓ **B)** inventories.
- X **C)** industrial production.
- X **D)** S&P 500.

Explanation

Increasing inventories result from a decrease in customer demand. This can occur when disposable income is dropping and economic conditions are deteriorating.

Reference: 14.6.2.1 in the License Exam Manual

Question #103 of 201

Question ID: 607065

Included in the working capital computation of a corporation are all of the following EXCEPT:

- ✓ **A)** convertible bonds it has issued.
- X **B)** marketable securities of other companies.
- X **C)** accounts receivable.
- X **D)** cash.

Explanation

The working capital of a corporation is equal to its current assets minus its current liabilities (a current liability is payable within 12 months). Because all bonds, convertible or not, issued by the corporation are long-term liabilities, they are not included in the working capital computation. Accounts receivable, marketable securities, and cash are short-term assets included in the calculation of working capital.

Reference: 14.6.1.3.5 in the License Exam Manual

Question #104 of 201

Question ID: 607097

Market interest rates have risen steadily over the past several months. The market price of which 2 of the following shares would probably reflect the biggest impact of this change?

- I. Growth stock.
- II. Money market mutual fund.

- III. Preferred stock.
- IV. Public utility stock.

- X **A)** II and III.
- ✓ **B)** III and IV.
- X **C)** I and IV.
- X **D)** I and II.

Explanation

Stocks that are interest rate sensitive will reflect the impact of a change to market interest rates more than others. Preferred stock with its fixed dividend and utility stocks with their high degree of debt leverage are considered interest rate sensitive. The yield of the money market fund will change, but the price is fixed at \$1 per share.

Reference: 14.7.1.1 in the License Exam Manual

Question #105 of 201

Question ID: 607037

In a rising price environment, which of the following inventory valuation methods will result in the highest reported earnings?

- X **A)** Straight line.
- ✓ **B)** FIFO.
- X **C)** LIFO.
- X **D)** Average cost.

Explanation

Using first in, first out (FIFO) means lower cost inventory is used first in determining the cost of goods sold. This has the effect of inflating earnings. Using last in, first out (LIFO) means higher cost inventory is used to determine the cost of goods sold. In a rising price environment, LIFO better matches cost with revenue.

Reference: 14.6.2.1. in the License Exam Manual

Question #106 of 201

Question ID: 607055

A company's balance sheet dated December 31 shows retained earnings of \$100,000. You can deduce from this information that the company:

- X **A)** has had total net income of \$100,000 since its inception.
- X **B)** earned a profit of \$100,000 for this year.
- ✓ **C)** has had \$100,000 in undistributed profits since its inception.
- X **D)** has at least \$100,000 in cash.

Explanation

Retained earnings represent the accumulated total of all earnings that have been retained in the company since its inception. It is quite possible that the company did not earn \$100,000 in that particular year and does not have \$100,000 in cash.

Reference: 14.6.1.3.3 in the License Exam Manual

Question #107 of 201

Question ID: 606912

Which of the following is a leading indicator of the economic future?

- X **A)** Unemployment statistics.
- ✓ **B)** Machine tool orders.
- X **C)** The Gross National Product.
- X **D)** The Consumer Price Index.

Explanation

Machine tool orders anticipate the business cycle, because they come first in the manufacturing process.

Question #108 of 201

Question ID: 606977

If the U.S. dollar depreciates in value, which of the following statements is NOT true?

- ☐ A) Foreign goods would become more expensive in the United States.
- ☐ B) The same number of yen would buy more dollars.
- ☐ C) The balance of payments deficit would probably be reduced.
- ☒ D) Travel abroad would be less expensive for Americans.

Explanation

If the dollar is devalued, travel abroad for Americans will become more expensive. Because the dollar is worth less, it will buy fewer London theater tickets, Swiss watches, or French perfumes. With a cheaper dollar, exports would probably rise and imports decrease, resulting in a smaller deficit in our balance of payments.

Reference: 14.3.1.1 in the License Exam Manual

Question #109 of 201

Question ID: 606910

When comparing the change in the GNP from one year to another, each year's GNP should be converted into:

- ☒ A) constant dollars.
- ☐ B) dollars in terms of gold bullion.
- ☐ C) dollars valued by the exchange ratios with foreign currencies.
- ☐ D) international dollars.

Explanation

The GNP measures growth in the economy. To retain an accurate comparison of one year to the next, it must be measured with constant dollars (inflation-adjusted dollars).

Reference: 14.1.1.1 in the License Exam Manual

Question #110 of 201

Question ID: 607050

The amount paid in excess of par value on the sale of common shares by an issuer is reflected in which of the following accounts on the corporate financial records?

- ☐ A) In the earned surplus.
- ☐ B) In the retained earnings.
- ☐ C) In the capital stock.
- ☒ D) In the paid-in surplus.

Explanation

Paid-in surplus, or capital surplus, is the excess over par value that investors pay for stock on its original issue. Generally, par value on common stock is a matter of record for accounting purposes.

Reference: 14.6.1.3.2 in the License Exam Manual

Question #111 of 201

Question ID: 607080

When analyzing a company's balance sheet, you notice that it is using the first in, first out (FIFO) accounting method to value its inventory. This information is most likely shown

- ☒ A) in a footnote to the balance sheet
- ☐ B) next to the inventory listing in the current assets portion of the balance sheet
- ☐ C) at the end of the balance sheet in a summary statement required by the SEC
- ☐ D) on the cover of the balance sheet or at the top of the first page

Explanation

Notations regarding accounting methods used, such as those for valuing inventory, would generally be found in the footnotes of the balance sheet.

Reference: 14.6.4 in the License Exam Manual

Question #112 of 201

Question ID: 606944

Through its open market operations, the Federal Reserve trades all of the following EXCEPT:

- X **A)** Ginnie Maes.
- ✓ **B)** Grant anticipation notes.
- X **C)** Treasury notes.
- X **D)** Treasury bills.

Explanation

The Federal Open Market Committee (FOMC) trades U.S. government and agency securities in the secondary market. Grant anticipation notes (GANs) are municipal securities.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #113 of 201

Question ID: 606991

Each of the following would cause a decrease in the balance of trade deficit EXCEPT:

- X **A)** an increase in dividends paid on U.S. stocks held by foreign investors.
- X **B)** an increase in dividends paid on foreign stocks to U.S. investors.
- ✓ **C)** an increase in imports of foreign products.
- X **D)** an increase in exports of U.S. products.

Explanation

The trade deficit occurs when imports exceed exports (as they have for years). We want to know which one of these would not be helpful to our balance of trade-that is, which one would cause the negative balance to increase. If you read it correctly, an increase in foreign imports is obviously correct since it is bad for our trade balance and would cause an increase in the deficit instead of a decrease.

Reference: 14.3.1.1 in the License Exam Manual

Question #114 of 201

Question ID: 606996

A fundamental analyst would be interested in all of the following EXCEPT:

- ✓ **A)** daily trading volumes on the NYSE.
- X **B)** corporate annual reports.
- X **C)** statistics of the U.S. Department of Commerce on disposable income.
- X **D)** innovations within the automotive industry.

Explanation

Trading volume interests the technical analyst, who looks at fluctuations in the market, not at fundamental economic values.

Reference: 14.4.1.1 in the License Exam Manual

Question #115 of 201

Question ID: 606927

Which of the following economists supports demand-side economics?

- X **A)** Adam Smith.
- ✓ **B)** John Maynard Keynes.

- X **C)** Arthur Laffer.
- X **D)** Milton Friedman.

Explanation

John Maynard Keynes was the first demand-side economist. He believed that by increasing the income available for spending and saving, a government could increase demand and improve the country's economic well-being. Higher taxes and higher government spending are key tenets of this theory.

Reference: 14.1.2.1 in the License Exam Manual

Question #116 of 201

Question ID: 607028

Buying stocks with high PE ratios normally reflects which of the following investment styles?

- X **A)** Special situations.
- ✓ **B)** Growth.
- X **C)** Value.
- X **D)** Turnaround.

Explanation

The purchase of stocks with high PE ratios represents a growth investment style. Growth-oriented investors will pay for high PE ratios. Value investment style is associated with the purchase of low PE stocks or stocks trading below their intrinsic value.

Reference: 14.5.1.3 in the License Exam Manual

Question #117 of 201

Question ID: 606964

A tool that is NOT used by the FRB to control the money supply is:

- X **A)** the required reserve rate.
- X **B)** the FOMC.
- X **C)** the discount rate.
- ✓ **D)** the prime rate.

Explanation

The prime rate is the rate of interest charged by banks to their best customers. The prime rate reacts to the FRB's tools, but it is not one of them.

Reference: 14.2.1.2 in the License Exam Manual

Question #118 of 201

Question ID: 606970

All of the following are purchasers of Treasury securities in the primary market EXCEPT:

- X **A)** financial institutions.
- X **B)** investment companies.
- ✓ **C)** the Federal Reserve Board.
- X **D)** commercial banks.

Explanation

The FRB trades in governments in the secondary market; they are not primary purchasers.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #119 of 201

Question ID: 606984

An upward sloping yield curve represents all of the following EXCEPT:

- ✓ **A)** foreign interest rate differentials.
- X **B)** increased risk of default over time.
- X **C)** time value of money.
- X **D)** inflation expectations.

Explanation

Foreign interest rate differentials are not reflected in an upward sloping yield curve. Interest rate differentials between countries reflect differences in domestic monetary and fiscal conditions. The time value of money is reflected in the upward sloping yield curve.

Reference: 14.3.1 in the License Exam Manual

Question #120 of 201

Question ID: 607051

If DMF Corporation issues \$10 million par value of convertible debentures, all of the following balance sheet items will be affected immediately EXCEPT:

- X **A)** the working capital.
- X **B)** the assets.
- ✓ **C)** the net worth.
- X **D)** the liabilities.

Explanation

Net worth (equity in the company) remains unchanged. Assets and liabilities both increase, as does the working capital.

Reference: 14.6.2 in the License Exam Manual

Question #121 of 201

Question ID: 606937

Industrial production is what kind of economic indicator?

- X **A)** Lagging.
- ✓ **B)** Coincident.
- X **C)** Leading.
- X **D)** Coterminous.

Explanation

Industrial production is a coincident economic indicator.

Reference: 14.1.1.3.2 in the License Exam Manual

Question #122 of 201

Question ID: 606908

Which of the following is a lagging indicator?

- X **A)** Housing starts.
- X **B)** Durable goods orders.
- ✓ **C)** Corporate profits.
- X **D)** The GNP.

Explanation

Corporate profits are a lagging indicator, as the economic direction has been established before it is reflected in corporate profits.

Reference: 14.1.1.3.3 in the License Exam Manual

Question #123 of 201

Question ID: 606931

What term do economists use to describe a downturn in the economy that is characterized by both unemployment and rising prices?

- ✓ **A)** Stagflation.
- X **B)** Inflation.
- X **C)** Depression.
- X **D)** Recession.

Explanation

"Stagflation" is the term used to describe the unusual combination of inflation and unemployment (stagnation).

Reference: 14.1.1.2.2 in the License Exam Manual

Question #124 of 201

Question ID: 606992

If the Federal Reserve Board tightens the money supply, this will

- I. push interest rates up
- II. push interest rates down
- III. allow consumers easier access to credit and loans
- IV. make access to credit and loans more difficult for consumers

- X **A)** II and IV
- ✓ **B)** I and IV
- X **C)** II and III
- X **D)** I and III

Explanation

When the FRB tightens the money supply, it takes dollars out of the economy. When the demand for credit and loans exceeds the available dollars, interest rates rise, making access to credit and loans more difficult for consumers.

Reference: 14.3.0.2 in the License Exam Manual

Question #125 of 201

Question ID: 721479

Each of the following would add to the balance of trade deficit EXCEPT:

- ✓ **A)** Foreign spending in the U.S.
- X **B)** U.S. investing abroad.
- X **C)** Imports of foreign goods into the U.S.
- X **D)** U.S. spending abroad.

Explanation

Any spending overseas by U.S. investors or consumers adds to the trade deficit. For instance, the trade deficit increases when imports of foreign goods exceed exports of U.S. goods. Foreign spending in the U.S. would decrease the balance of trade deficit.

Reference: 14.3.1.1 in the License Exam Manual

Question #126 of 201

Question ID: 607032

Which of the following stocks is regarded as a defensive stock?

- X **A)** Stock selling close to its support level.
- ✓ **B)** Electric utility stock.
- X **C)** Stock with a strong cash position and a low ratio of debt.
- X **D)** Aerospace stock.

Explanation

Analysts regard a defensive stock as one that is in an industry that is least affected by business cycles. Most defensive industries produce nondurable consumer goods (for example, the food industry or the utility industry).

Reference: 14.5.1.1 in the License Exam Manual

Question #127 of 201

Question ID: 607084

Several of your firm's customers have expressed interest in a new non-traded business development company (BDC). Which of the following customer accounts would be considered LEAST suited for this type of investment?

- X **A)** A joint retail account showing a couple with a net worth of \$1 million dollars, approved for both margin transactions and uncovered options trading.
- X **B)** An institutional trading account with over \$100 million dollars to invest having a history of investing in new opportunities.
- X **C)** An individual retail customer account with several million dollars currently invested in both equity and debt products and a customer profile showing her as having made private equity investments in the past.
- ✓ **D)** A joint retail account currently valued at \$1 million with a short-term investment time horizon noted due to anticipated upcoming college expenses.

Explanation

While there could certainly be a number of factors for each account that are left unaddressed such as age, employment status and investment criteria, test takers must rely on only the information given when answering suitability or recommendation questions. Of the profiles listed this type of investment would be the least suitable for the account having a short investment time horizon. The non-traded characteristic of this BDC makes illiquidity a primary factor to be considered. All of the other accounts show evidence of either being more likely to afford such an investment, having investment experience with similar investments in the past, or already being approved for investments or types of accounts that have inherent risk characteristics associated with them.

Reference: 14.6.2.9.1 in the License Exam Manual

Question #128 of 201

Question ID: 606943

Which of the following are part of M2, but NOT M1?

- X **A)** Currency in circulation.
- X **B)** Checking accounts at commercial banks.
- ✓ **C)** Money market mutual funds.
- X **D)** Demand deposits at S&Ls.

Explanation

Money market funds are part of M2, but not M1. M2 includes everything in M1, plus time deposits and money market funds.

Reference: 14.2.1.1 in the License Exam Manual

Question #129 of 201

Question ID: 607030

The investment policy department of an investment firm forecasts that the current business cycle should reach its peak within the next 2 months. Under such circumstances, which of the following purchases would be *most* suitable for the firm's customers who actively invest in common stocks?

- X **A)** Corporate bonds
- ✓ **B)** Defensive stocks
- X **C)** Aggressive growth stocks
- X **D)** Cyclical stocks

Explanation

Defensive stocks such as those in the food, pharmaceuticals, and energy industries would most likely be suitable for investors who actively manage their equity portfolios. Defensive stocks are least likely to be affected by a reversal in the business cycle.

Reference: 14.5.1.1 in the License Exam Manual

Question #130 of 201

Question ID: 606971

If the Federal Open Market Committee (FOMC) purchases T-bills in the open market, which of the following scenarios are likely to occur?

- I. Secondary bond prices will rise.
- II. Secondary bond prices will fall.
- III. Interest rates will rise.
- IV. Interest rates will fall.

- ☐ A) II and IV.
- ☐ B) II and III.
- ☐ C) I and III.
- ☒ D) I and IV.

Explanation

When the FOMC purchases T-bills in the open market, it pays for the transaction by increasing member banks' reserve accounts. The net effect of this action increases the total money supply and signals a period of relatively easier credit conditions, declining interest rates, and a rise in the price for existing or secondary bonds.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #131 of 201

Question ID: 607000

An analyst interested in measuring the breadth of market movement as an indicator of future market direction would monitor the:

- ☐ A) Value Line Index.
- ☐ B) DJIA.
- ☒ C) advance/decline line.
- ☐ D) betas of the S&P 500 stocks.

Explanation

The advance/decline line, which measures the number of stocks that have advanced versus the number of stocks that have declined, is an indicator of the breadth of the market's advance or decline.

Reference: 14.4.1.2 in the License Exam Manual

Question #132 of 201

Question ID: 606940

The economy has experienced several months of slow economic growth and rising unemployment. Market analysts would describe this as a period of

- ☐ A) deflation
- ☐ B) inflation
- ☐ C) stagflation
- ☒ D) stagnation

Explanation

Economists define stagnation as prolonged periods of slow or little economic growth accompanied by high unemployment.

Reference: 14.1.1.2.4 in the License Exam Manual

Question #133 of 201

Question ID: 606917

A report by the federal government stating the Consumer Price Index (CPI) has increased by .3% indicates:

- ☐ A) consumers purchased .3% more higher-priced products than lower-priced products.
- ☐ B) consumers purchased .3% more goods that month.
- ☐ C) the economy experienced deflation.
- ☒ D) the cost of goods purchased by consumers increased, on average, .3% for the month.

Explanation

The Consumer Price Index (CPI) is a statistic used by the federal government to measure month-to-month changes in prices to the end-consumer. It includes prices on items such as food, oil, and clothing. The CPI is usually used to indicate the general inflation rate of the economy.

Reference: 14.1.1.2.1 in the License Exam Manual

Question #134 of 201

Question ID: 607041

Which of the following balance sheet items is NOT a current liability?

- ☐ A) Accrued taxes.
- ☐ B) Accounts payable.
- ☒ C) Mortgages.
- ☐ D) Long-term debt amount that is due within 1 year.

Explanation

Short-term or current liabilities are those entries on a balance sheet that are due in 1 year or less. Accounts payable, accrued taxes, and that portion of long-term debt due within the year are all current liabilities. Mortgages are generally long-term liabilities, although that portion of a mortgage that is due within the year would be classified on the balance sheet as a current liability.

Reference: 14.6.1.2.2 in the License Exam Manual

Question #135 of 201

Question ID: 606914

The economy has gone through three consecutive quarters of economic decline with no immediate end in sight, and therefore could be said to be:

- ☐ A) Lagging.
- ☐ B) in a Depression.
- ☒ C) in a Recession.
- ☐ D) in a Recovery.

Explanation

Recession is defined as 2 or more consecutive quarters of economic decline. It would have to be at least 6 quarters to be considered a depression.

Reference: 14.1.1 in the License Exam Manual

Question #136 of 201

Question ID: 606920

Which of the following would be characterized as a coincident indicator?

- ☐ A) New housing starts.
- ☐ B) First-time unemployment claims.
- ☐ C) Prime rate.
- ☒ D) Industrial production.

Explanation

Housing starts and unemployment claims are leading indicators, whereas prime rate is a lagging indicator. Only industrial production is coincident to the current economy.

Reference: 14.1.1.3.2 in the License Exam Manual

Question #137 of 201

Question ID: 606911

Which of the following is a coincident economic indicator?

- ☐ A) Capital goods purchased.

- X **B)** The S&P 500 Index.
- X **C)** Housing starts.
- ✓ **D)** Industrial production.

Explanation

Coincident economic indicators measure the strength of the current economy at specific intervals. Industrial production is such an indicator.

Reference: 14.1.1.3.2 in the License Exam Manual

Question #138 of 201

Question ID: 607075

One company is guaranteeing the debt service of another company (guaranteed bond). In which of the following scenarios is this most likely to occur?

- ✓ **A)** In a spin-off where one company, the parent company, has divested itself of some equity and some debt to form a separate company
- X **B)** When a company guarantees the debt of one of its own existing creditors
- X **C)** Never, because SEC rules prohibit "guaranteed" bonds
- X **D)** When 2 competitors have merged

Explanation

Of the scenarios listed, in a spin-off, where one company, a parent company, divests itself of some of its equity and debt to form a new separate company, it is likely that the parent company would guarantee the debt of the new company.

Reference: 14.6.2.7 in the License Exam Manual

Question #139 of 201

Question ID: 606981

The term "disintermediation" refers to:

- X **A)** using margin to leverage one's returns.
- ✓ **B)** the flow of money from traditional, low-yielding savings accounts to higher- yielding money market instruments.
- X **C)** the flow of money from money market instruments into traditional savings vehicles.
- X **D)** protecting a diversified portfolio through the purchase of index put options.

Explanation

This is the industry-accepted definition of disintermediation, and it typically occurs when the Federal Reserve Board tightens the money supply and interest rates rise faster in the marketplace than at bank accounts.

Reference: 14.3.0.3 in the License Exam Manual

Question #140 of 201

Question ID: 607062

Stock of which of the following companies trades on equity?

- ✓ **A)** Public utility.
- X **B)** Car manufacturer.
- X **C)** Drug manufacturer.
- X **D)** Steel manufacturer.

Explanation

Trading on equity relates to a highly leveraged company. Utility companies are normally highly leveraged.

Reference: 14.6.2.8 in the License Exam Manual

Question #141 of 201

Question ID: 607010

The Dow Jones Industrial Average is which of the following?

- ☐ A) Unweighted average of 30 stocks, primarily transportation.
- ☒ B) Price-weighted average of 30 stocks, primarily industrial.
- ☐ C) Unweighted average of 300 stocks, primarily transportation.
- ☐ D) Price-weighted average of 300 stocks, primarily industrial.

Explanation

The Dow Jones Industrial Average (DJIA), published by Dow Jones & Company, is a price-weighted average of 30 stocks. These stocks represent primarily industrial corporations but also include AT&T, American Express, and Microsoft.

Reference: 14.4.3.5 in the License Exam Manual

Question #142 of 201

Question ID: 606983

If the dollar weakens, which of the following statements is TRUE?

- ☐ A) Foreign securities denominated in their domestic currency decrease in value to the U.S. investor.
- ☐ B) The dollar buys more foreign currency.
- ☐ C) U.S. exports will fall.
- ☒ D) A rise in U.S. interest rates might strengthen the dollar.

Explanation

If U.S. interest rates rise, foreign investors would invest in U.S. dollar-denominated securities, thereby increasing the demand for dollars and causing the dollar to strengthen.

Reference: 14.3.1 in the License Exam Manual

Question #143 of 201

Question ID: 607100

A company reported annual earnings of \$2.40 per share and paid annual dividends of \$.60. If the dividends were distributed quarterly, what was the amount and payout rate?

- ☐ A) \$.60 at 25%.
- ☒ B) \$.15 at 25%.
- ☐ C) \$.60 at 10%.
- ☐ D) \$.15 at 6.25%.

Explanation

One quarter of \$.60 is \$.15. \$.60 is 25% of \$2.40.

Reference: 14.7.3.5 in the License Exam Manual

Question #144 of 201

Question ID: 606990

If the U.S. dollar has been appreciating against foreign currencies, all of the following statements are true EXCEPT:

- ☐ A) U.S. goods become more expensive in foreign countries.
- ☐ B) foreign goods become cheaper in the United States.
- ☐ C) the U.S. dollar buys more of foreign currencies.
- ☒ D) U.S. exports become more competitive.

Explanation

The U.S. exports will cost more to foreigners and become less competitive. The dollar is worth more in terms of foreign currencies and will purchase more foreign goods per dollar.

Reference: 14.3.1.1 in the License Exam Manual

Question #145 of 201

Question ID: 607029

If a registered representative were explaining the characteristics of different stocks and industries to a customer, it would be CORRECT to say that:

- I. automobile stocks are cyclical.
- II. pharmaceutical stocks are cyclical.
- III. companies producing appliances are defensive.
- IV. the tobacco industry is defensive.

- ☐ A) II and IV.
- ☐ B) II and III.
- ☐ C) I and III.
- ☒ D) I and IV.

Explanation

Cyclical industries and stocks, such as those producing durable goods like automobiles, are highly sensitive to business cycles and inflation trends. Defensive industries are least affected by normal business cycles. Companies in defensive industries generally produce nondurable consumer goods, such as food, pharmaceuticals, and tobacco.

Reference: 14.5.1.2 in the License Exam Manual

Question #146 of 201

Question ID: 606930

Which of the following is considered the *most* accurate method of measuring GDP?

- ☐ A) As a function of GNP.
- ☐ B) Actual dollars.
- ☒ C) Constant dollars.
- ☐ D) Eurodollars.

Explanation

Constant dollars are mathematically adjusted to remove the effects of inflation, so when economists compare the gross domestic product of one period with that of another, they measure economic activity rather than inflation.

Reference: 14.1.1.1 in the License Exam Manual

Question #147 of 201

Question ID: 607071

If XYZ Corporation sells an additional 1 million common stock with a par value of \$1 for \$10 per share, which of the following is TRUE?

- ☐ A) Current ratio will decrease.
- ☐ B) Its EPS will increase.
- ☐ C) Its liquidity ratio will decrease.
- ☒ D) Its paid-in surplus will increase.

Explanation

Paid-in surplus is a balance sheet entry that accounts for money raised from the issuance of stock in excess of par value. When more shares are sold, paid-in surplus will increase.

Reference: 14.6.1.3.2 in the License Exam Manual

Question #148 of 201

Question ID: 721481

When a company issues additional bonds, which of the following is true?

- ☐ A) Leverage is decreased
- ☐ B) It cannot be determined only knowing that additional bonds have been issued
- ☐ C) Leverage is not affected when debt securities are issued
- ☒ D) Leverage is increased

Explanation

Leverage is the use of someone else's money at a fixed cost to benefit the common shareholders. Issuing additional bonds increases the company's debt (money borrowed from someone else) and therefore increases leverage for shareholders.

Reference: 14.7.1.1 in the License Exam Manual

Question #149 of 201

Question ID: 606988

XYZ Aircraft Manufacturing Corporation announces a multimillion dollar order for its new jumbo jet from Fly Airlines, a Japanese carrier. When the sale is completed, there will be:

- ✓ **A)** a credit to the current account of the U.S.
- X **B)** a debit to the current account of the U.S.
- X **C)** no effect on the balance of trade.
- X **D)** a credit to the current account of Japan.

Explanation

Whenever money from a foreign source enters the United States, it becomes a credit item in the U.S. balance of payments.

Reference: 14.3.1.1 in the License Exam Manual

Question #150 of 201

Question ID: 607085

A small retail investor wants to invest in a growth development company. Which of the following should be of the most concern regarding suitability?

- ✓ **A)** Whether the growth development company is traded or nontraded
- X **B)** Whether or not the SEC has approved the growth development company
- X **C)** That the capital being provided is going to startup companies
- X **D)** That these companies allow for the general investing public to participate

Explanation

Growth development companies, also known as business development companies (BDCs), allow smaller, nonaccredited investors the opportunity to invest in startup ventures. Providing startup capital to companies and allowing smaller investors the opportunity to participate are simply characteristics of BDCs. Of course, the SEC does not approve or disapprove of any investment so this would not be a suitability concern. However, from a suitability perspective, a small retail investor should be most concerned with liquidity and being able to divest easily if they need to. In this light, whether the company is traded or nontraded would be very important as nontraded development companies are viewed as being illiquid and the opportunity to exit the investment may be limited and come at a discount to current market value.

Reference: 14.6.2.9.1 in the License Exam Manual

Question #151 of 201

Question ID: 607096

A corporation has \$12 million net income after taxes, 5 million common shares outstanding, and \$10 million of 6% preferred stock (\$100 par). What is the corporation's earnings per share (EPS)?

- ✓ **A)** \$2.28.
- X **B)** \$2.52.
- X **C)** \$2.40.
- X **D)** \$1.20.

Explanation

Begin by calculating how much of the net income is available for common stockholders (net income after taxes minus preferred dividends equals earnings available for common stockholders). The preferred stockholders received \$600,000 in dividends (100,000 pfd shares × \$6 per share dividends = \$600,000). After subtracting \$600,000 from the net income of \$12 million, this leaves \$11.4 million (earnings available for common stockholders). Compute EPS (earnings available for common ÷ number of common shares outstanding = \$11.4 million / 5 million shares = \$2.28 per share EPS).

Reference: 14.7.3.1 in the License Exam Manual

Question #152 of 201

Question ID: 606916

The economic philosophy that believes in controlling the money supply to stimulate economic growth is often referred to as:

- ✓ **A)** the Monetarist Economic Theory.
- X **B)** the Demand Side Economic Theory.
- X **C)** the Supply Side Economic Theory.
- X **D)** the Fiscal Economic Theory.

Explanation

Controlling the money supply implies a hands-on theory that is referred to as the Monetarist Theory.

Reference: 14.1.2.2 in the License Exam Manual

Question #153 of 201

Question ID: 607040

Balance sheets contain:

- X **A)** gross revenues for the year.
- ✓ **B)** the net worth of the firm as of the date of the balance sheet.
- X **C)** no reference to the accounting methods used to construct the balance sheet.
- X **D)** the amount of cash and cash equivalents expended during the first half of the fiscal year as opposed to the second half.

Explanation

The balance sheet provides a snapshot of the financial condition of the firm on that date. It does not provide information on the flow of expenses, revenues, and cash during the reporting period as they would appear on the income statement.

Reference: 14.6.1.2 in the License Exam Manual

Question #154 of 201

Question ID: 607106

Your customer asks you to help evaluate several companies she is considering adding to her portfolio. One of the tools you are using is the asset coverage ratio to assess

- X **A)** if the company has raised enough debt capital to purchase new tangible assets such as buildings and equipment
- ✓ **B)** the value of the assets the company holds, both tangible and monetary, in relation to its debt obligations
- X **C)** if the company has enough in liquid assets only to cover its debt obligations
- X **D)** if the company can cover the cost of new inventory using only its monetary assets

Explanation

The asset coverage ratio measures the tangible and monetary assets of a company in relation to its outstanding debt obligations. It is but one tool that can be utilized to assess the overall strength or weakness of a company's financial health.

Reference: 14.7.2.1.1 in the License Exam Manual

Question #155 of 201

Question ID: 607012

In the assessment of a company's stock, a technical analyst takes into consideration all of the following EXCEPT:

- X **A)** volume.
- X **B)** price momentum.
- X **C)** market price.
- ✓ **D)** earnings.

Explanation

A market technician (technical analyst) deals primarily with timing of activity and market trends, while a fundamental analyst centers on a particular industry or company within an industry and its relative health and market potential.

Question #156 of 201

Question ID: 606974

If the U.S. dollar has fallen relative to foreign currencies, which of the following statements are TRUE?

- I. U.S. exports are likely to rise.
- II. U.S. exports are likely to fall.
- III. Foreign currencies buy fewer U.S. dollars.
- IV. Foreign currencies buy more U.S. dollars.

- ☐ A) II and IV.
- ☐ B) I and III.
- ☐ C) II and III.
- ☒ D) I and IV.

Explanation

When the U.S. dollar loses value compared to a foreign currency, the same amount of the foreign currency now buys more dollars. As a result, U.S. goods are cheaper in terms of that foreign currency, which means that the foreign country and its residents tend to buy more U.S. products and U.S. exports rise.

Reference: 14.3.1.1 in the License Exam Manual

Question #157 of 201

Question ID: 607018

Analysts who are *most* interested in confirming a market trend would use:

- ☒ A) technical analysis.
- ☐ B) fundamental analysis.
- ☐ C) random walk theory.
- ☐ D) confidence theory.

Explanation

Technical analysis involves the confirmation of market and pricing trends through charts and market indicators. The decision to buy or sell stock is made by these trends rather than by analysis of specific issuer financial information, as used by fundamental analysts.

Reference: 14.4 in the License Exam Manual

Question #158 of 201

Question ID: 606997

The S&P 100 Index and the Wilshire Index are examples of

- ☐ A) standardized, capped equity options.
- ☐ B) single security futures options.
- ☒ C) broad-based indexes.
- ☐ D) narrow-based indexes.

Explanation

Broad-based indexes attempt to reflect the status of the market as a whole, not the status of particular market segments such as a gold or oil index.

Reference: 14.4.3.5 in the License Exam Manual

Question #159 of 201

Question ID: 607069

The issuance of a debenture by a company would have an immediate effect on which of the following balance sheet items?

- I. The total assets.
- II. The total liabilities.

- III. The working capital.
- IV. The shareholders' equity.

- ✓ **A)** I, II and III.
- X **B)** I, II and IV.
- X **C)** II, III and IV.
- X **D)** I, III and IV.

Explanation

The cash received from the sale of the bonds is a current asset of the company and as such would increase assets and working capital on the balance sheet. The debentures are debts of the company and would increase the liabilities of the company. Shareholders' equity is only affected by gains, losses, new invested capital, and cash distributions (dividends) to shareholders.

Reference: 14.6.1.2 in the License Exam Manual

Question #160 of 201

Question ID: 606962

All of the following might be done by the Federal Reserve to influence interest rates and the money supply EXCEPT:

- X **A)** buy or sell short term treasury debt.
- ✓ **B)** adjust marginal tax rates.
- X **C)** change the reserve requirement.
- X **D)** raise or lower the discount rate.

Explanation

The Federal Reserve implements monetary policy. Taxation is part of fiscal policy, and only Congress has the ultimate authority to raise or lower taxes.

Reference: 14.2.1.2 in the License Exam Manual

Question #161 of 201

Question ID: 606915

Which of the following choices does NOT influence the level of interest rates?

- X **A)** Federal Reserve's monetary policy.
- X **B)** Inflation expectations.
- X **C)** Amount of loanable funds in the financial markets.
- ✓ **D)** New housing starts.

Explanation

New housing starts are affected by the level of interest rates, but they are not a factor in the determination of interest rates. Interest rates are determined by the supply and demand for loanable funds. The more money that is available for lending, the lower the rates.

Reference: 14.1.1.3.1 in the License Exam Manual

Question #162 of 201

Question ID: 607007

A technical analyst is *least* concerned with:

- X **A)** new highs and lows.
- X **B)** trading volume.
- X **C)** open short positions.
- ✓ **D)** declaration of increased dividends.

Explanation

A technical analyst is interested in statistics about market or price performance, not the fundamental factors, the market, or the company's dividend policy. Technical analysts are interested in trading volume as a market statistic, new highs and lows, and open short positions, which could indicate future buying potential in the security.

Question #163 of 201

Question ID: 607022

The investment theory that assumes the market adjusts automatically as new information becomes known or relevant about a particular security, thereby resulting in a fair market price at all times, is known as:

- ☐ A) Dow theory.
- ☐ B) Odd-lot theory.
- ☐ C) Supply side economics.
- ☒ D) Efficient market theory.

Explanation

The efficient market theory is based on the hypothesis that markets adjust automatically and quickly to relevant information regarding a security as it becomes known. In theory, this results in fair and efficient pricing at all times.

Reference: 14.4.3.5 in the License Exam Manual

Question #164 of 201

Question ID: 606948

The Fed is making purchases in the open market. What are the effects of this action?

- I. The money supply will become tighter.
- II. The federal funds rate is likely to go down.
- III. Bank reserves are likely to decrease.
- IV. Bond prices are likely to rise.

- ☒ A) II and IV.
- ☐ B) II and III.
- ☐ C) I and III.
- ☐ D) I and IV.

Explanation

When the Federal Reserve Board purchases securities in the open market, money flows into the economy. Because there is more money available, interest rates such as the federal funds rate are likely to fall. When interest rates fall, bond prices rise.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #165 of 201

Question ID: 607049

A corporation has a net income of \$5.2 million after taxes. If 4 million shares of common stock are outstanding, the earnings per share is:

- ☐ A) \$0.80.
- ☒ B) \$1.30.
- ☐ C) \$1.78.
- ☐ D) \$5.20.

Explanation

Earnings per share equals net income (less preferred dividends) divided by the number of common shares outstanding. In this case, \$5.2 million divided by 4 million equals an EPS of \$1.30.

Reference: 14.6.3.4 in the License Exam Manual

Question #166 of 201

Question ID: 607067

Which of the following capital structures would be considered the *most* highly leveraged?

- ✓ **A)** A large value of bonds and a small value of common stock.
- X **B)** A large value of common stock and a small value of bonds.
- X **C)** Equal values of common stock and bonds.
- X **D)** Common stock only.

Explanation

Leverage is using other people's money to enhance equity value. In this case, borrowing at a fixed-rate of payment enhances cash flow, giving the company extra money to invest in its operations. Just as individuals, a company has to be careful not to borrow more than they can afford.

Reference: 14.6.2.8 in the License Exam Manual

Question #167 of 201

Question ID: 607057

All of the following appear on a corporation's balance sheet as fixed assets EXCEPT:

- X **A)** computer equipment.
- X **B)** real estate.
- ✓ **C)** inventory.
- X **D)** furniture.

Explanation

Inventory is considered a current asset, not a fixed asset, because the company expects to convert its inventory into cash within a short period of time. The other choices are fixed assets and cannot be liquidated easily.

Reference: 14.6.1.2.1 in the License Exam Manual

Question #168 of 201

Question ID: 606966

If the FOMC is buying Treasury bills, this indicates that yields will:

- X **A)** increase.
- X **B)** not change.
- ✓ **C)** decrease.
- X **D)** not be affected.

Explanation

When the FOMC is buying T-bills, it is increasing the money supply. This causes yields to decrease.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #169 of 201

Question ID: 607005

Which of the following is the broadest index?

- X **A)** The S&P 500.
- ✓ **B)** The Wilshire Index.
- X **C)** The Dow Jones Industrial Average.
- X **D)** The S&P 100.

Explanation

Of the choices listed, the Wilshire Index, commonly referred to as the Wilshire 5000, contains the greatest number of securities. In contrast, the Dow Jones Industrial Average (DJIA) represents the thinnest selection of stocks.

Reference: 14.4.3.5 in the License Exam Manual

Question #170 of 201

Question ID: 606968

Which of the following activities of the FRB would cause interest rates to increase?

- ✓ **A)** An increase in the reserve requirements.
- X **B)** A reduction in the reserve requirements.
- X **C)** An increase in the purchase of government securities by the FOMC.
- X **D)** A reduction in the discount rate.

Explanation

Interest is the cost of borrowing money. If less money is available, the cost (interest rates) of borrowing will go up (supply and demand). Therefore, anything the FRB does to reduce the money supply will increase interest rates.

Reference: 14.2.1.2.3 in the License Exam Manual

Question #171 of 201

Question ID: 607015

A technical analyst is concerned with all of the following trends EXCEPT:

- X **A)** reversals.
- X **B)** changes in the DJIA.
- ✓ **C)** PE ratios.
- X **D)** support levels.

Explanation

Technical analysts are more interested in forecasting market trends and securities prices than in studying individual corporations. Therefore, they are concerned with market prices, trading volumes, changes in the Dow Jones Industrial Average, reversals, support and resistance levels, advance/decline lines, short interest, and many other factors that might help them time buying and selling decisions. Fundamental analysts, on the other hand, concentrate on a stock's intrinsic quality and are concerned with PE ratios and earnings per share.

Reference: 14.4 in the License Exam Manual

Question #172 of 201

Question ID: 607002

While looking at a chart for QRS common stock, a technical trader wants to have an order in position in the event that QRS moves higher and breaks out on the chart. A buy stop order would be placed:

- ✓ **A)** just above the resistance level.
- X **B)** just below the support level.
- X **C)** just above the support level.
- X **D)** just below the resistance level.

Explanation

To take advantage of a stock moving higher and breaking out on a chart, a technical trader would place a buy stop order just above the resistance level. Technical traders believe that if a stock breaks the resistance level, it will move to and trade within a higher price range. Using a buy stop order placed just above the resistance level ensures that the purchase is not made until the stock has broken through the resistance.

Reference: 14.4.2.2 in the License Exam Manual

Question #173 of 201

Question ID: 607098

The dividend payout ratio of common stock is found by dividing the annual dividend per share by:

- X **A)** the capitalization per share.
- X **B)** the book value.
- ✓ **C)** the earnings per share.
- X **D)** the market price.

Explanation

The key to the question is ratio, which in this case is the relationship between dividends per share and their source of earnings per share.

Reference: 14.7.3.5 in the License Exam Manual

Question #174 of 201

Question ID: 607054

Which of the following may be affected when a company declares a cash dividend?

- I. Shareholders' equity.
- II. Total assets.
- III. Total liabilities.
- IV. Current assets.

- X **A)** II and IV.
- X **B)** III and IV.
- X **C)** I and II.
- ✓ **D)** I and III.

Explanation

When a company declares a cash dividend, it will reduce retained earnings (part of shareholders' equity) and increase current liabilities (dividends payable), which will increase total liabilities. Assets are not affected until the cash is paid out several weeks later.

Reference: 14.6.2.5 in the License Exam Manual

Question #175 of 201

Question ID: 607061

An increase in which of the following economic indicators would predict a decrease in business activity?

- X **A)** Expenditures on plant and equipment.
- X **B)** Building permits.
- X **C)** Personal incomes.
- ✓ **D)** Levels of inventories.

Explanation

The buildup of inventories is a disincentive for manufacturers to produce more goods and, therefore, may indicate a decrease in business activity. Increase in personal incomes, building permits, and expenditures on plant and equipment point to an increase in business activity.

Reference: 14.6.2.1 in the License Exam Manual

Question #176 of 201

Question ID: 606918

Newspaper reports indicate that the GDP has been declining steadily over the past 2 quarters. This would suggest:

- X **A)** expansion.
- ✓ **B)** a recession.
- X **C)** a depression.
- X **D)** inflation.

Explanation

Recession is 6 consecutive months of economic decline. Depression is 6 consecutive quarters of economic decline.

Reference: 14.1.1 in the License Exam Manual

Question #177 of 201

XYZ corporation divests itself of all of the shares of another company it owns. This is known as:

- ✓ **A)** a spin-off.
- X **B)** a recapitalization.
- X **C)** a merger.
- X **D)** an acquisition.

Explanation

When one company sells all of the shares of another it owns, this is called a spin-off.

Reference: 14.6.2.7 in the License Exam Manual

Question #178 of 201

Question ID: 606928

To determine the amount of change in the GDP from one year to another, both years' GDP should be converted into:

- ✓ **A)** constant dollars.
- X **B)** the current dollar price of gold bullion.
- X **C)** international depositary receipts.
- X **D)** the exchange value of the dollar, as compared with major foreign currencies.

Explanation

To compare GDP from one year to another, and thus to compare the amount of actual economic activity, economists use constant dollars to eliminate distortions caused by inflation.

Reference: 14.1.1.2.1 in the License Exam Manual

Question #179 of 201

Question ID: 607027

If a customer purchases a food company stock and a utility stock, the customer's portfolio is:

- X **A)** balanced.
- X **B)** cyclical.
- ✓ **C)** defensive.
- X **D)** diversified.

Explanation

Food company stocks and utilities are defensive investments. Defensive investments are those that tend to hold up well in economic downturns.

Reference: 14.5.1.1 in the License Exam Manual

Question #180 of 201

Question ID: 607047

If a corporation has a dividend payout ratio of 70%, the undistributed earnings will:

- ✓ **A)** increase retained earnings.
- X **B)** increase earnings per share.
- X **C)** decrease book value.
- X **D)** increase capital surplus.

Explanation

Retained earnings represent income that has not been paid out to shareholders.

Reference: 14.6.3.5 in the License Exam Manual

Question #181 of 201

Question ID: 606934

Which of the following is the CORRECT order of the stages in a business cycle?

- ☐ A) Peak, expansion, contraction, trough.
- ☐ B) Trough, contraction, expansion, peak.
- ☐ C) Contraction, trough, peak, expansion.
- ☒ D) Expansion, peak, contraction, trough.

Explanation

The correct order for the stages of a business cycle is expansion followed by a peak, then a contraction that ends in a trough. The cycle then repeats. Note that because this order represents a cycle, the correct answer has no set starting point or ending point as long as the stages are shown in the right order.

Reference: 14.1.1 in the License Exam Manual

Question #182 of 201

Question ID: 607008

A technical analyst is *least* likely to consider which of the following when selecting securities?

- ☒ A) Corporate earnings.
- ☐ B) Advance/decline line.
- ☐ C) Short interest ratio.
- ☐ D) Trend lines.

Explanation

Corporate earnings would be of least interest to a technical analyst, who is interested in market statistics indicative of future buying, market statistics that could reflect price or market trends, and trading volume.

Reference: 14.4 in the License Exam Manual

Question #183 of 201

Question ID: 607009

Four of the *best*-known indexes and averages are listed below. How do they rank on the scale of *most* to fewest issues in the index?

- I. Dow Jones Industrial Average
- II. NYSE Composite Index
- III. Standard & Poor's 500
- IV. Wilshire

- ☐ A) III, II, IV, I
- ☐ B) I, IV, III, II
- ☒ C) IV, II, III, I
- ☐ D) II, III, I, IV

Explanation

Of the indexes and averages listed, the Wilshire, sometimes referred to as the Wilshire 5000, is the broadest measure of the market; it contains more than 5,000 issues (exchange listed and OTC securities). The NYSE Composite Index is based on the prices of all of the common stocks listed on the Exchange. The S&P 500, as the name implies, is based on the prices of 500 stocks. The index recording the fewest issues is the Dow Jones Industrial Average-only 30 stocks.

Reference: 14.4.3.5 in the License Exam Manual

Question #184 of 201

Question ID: 606947

If the Fed begins selling securities in the open market to tighten credit, what is the first interest rate to feel this change in the Fed policy?

- ☒ A) Federal funds rate.
- ☐ B) Discount rate.

- ☐ C) Prime rate.
- ☐ D) Interest rate on long-term debentures.

Explanation

The Federal Reserve Board's actions to influence the money supply are first felt on the federal funds rates.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #185 of 201

Question ID: 606980

A significant increase in imports of foreign goods into the United States would have what effect on the strength of the US dollar?

- ☒ A) Weaken.
- ☐ B) Fluctuation both ways.
- ☐ C) Strengthen.
- ☐ D) No effect.

Explanation

Importing tends to weaken the dollar because it indicates an outflow of money from the United States to foreign countries. Much of this outflow is in the form of debt. When our debt (deficit in balance of payments) gets too high, there is international concern about our ability to pay our debts and a reluctance in accepting U.S. dollars as payment for goods-our dollar weakens.

Reference: 14.3.1.1 in the License Exam Manual

Question #186 of 201

Question ID: 607056

SSS Corporation's total assets amount to \$780,000 of which \$260,000 represents current assets. Total liabilities equal \$370,000, of which \$200,000 is considered long-term or other liabilities. What is SSS Corporation's shareholders' equity?

- ☐ A) \$170,000.
- ☐ B) \$1,150,000.
- ☐ C) \$980,000.
- ☒ D) \$410,000.

Explanation

Total assets minus total liabilities equals shareholders' equity ($\$780,000 - \$370,000 = \$410,000$).

Reference: 14.6.1.3 in the License Exam Manual

Question #187 of 201

Question ID: 607103

If XYZ common stock has a \$4 dividend, a yield of 4.2%, a PE ratio of 12, and is trading at \$96, its approximate earnings per share (EPS) is:

- ☐ A) \$4.00.
- ☐ B) \$48.00.
- ☒ C) \$8.00.
- ☐ D) \$50.40.

Explanation

The stock's PE ratio is price to earnings per share (EPS). Dividing the stock's price by the PE will give the earnings per share ($\$96 / 12 = \8 EPS).

Reference: 14.7.3.1 in the License Exam Manual

Question #188 of 201

Question ID: 607017

A head and shoulders bottom formation is an indication of:

- ☐ A) the reversal of an upward trend.
- ☒ B) the reversal of a downtrend.
- ☐ C) a bullish market.
- ☐ D) a bearish market.

Explanation

A head and shoulders bottom formation is also known as an inverted head and shoulders formation. It is that part of a graph in which a downtrend has reversed to become an uptrend. It is not, however, an indicator of the bullishness or bearishness of the market as a whole. It is an indication only of the direction of a trend, which may be either short or long in duration.

Reference: 14.4.2.1.2 in the License Exam Manual

Question #189 of 201

Question ID: 606909

Which of the following would *most* likely be considered a leading economic indicator?

- ☐ A) The GNP.
- ☐ B) The CPI.
- ☒ C) The S&P 500.
- ☐ D) Bankrupt businesses.

Explanation

Leading indicators tend to forecast business cycles in the economy, such as securities markets. The best answer is the S&P 500.

Reference: 14.1.1.3.1 in the License Exam Manual

Question #190 of 201

Question ID: 607074

Which of the following describes when debt is used to acquire a firm?

- ☐ A) Spin-off.
- ☒ B) Leveraged buyout (LBO).
- ☐ C) Hostile takeover.
- ☐ D) Takeover arbitrage.

Explanation

Financial leverage is a company's ability to use long-term debt to increase its return on equity. Acquiring another firm using debt is one way a company might attempt to do this. Using debt in this way is known as a leveraged buyout.

Reference: 14.6.2.8 in the License Exam Manual

Question #191 of 201

Question ID: 606919

Active government manipulation of the economy through tax and budget policies is referred to as:

- ☒ A) Keynesian.
- ☐ B) supply side.
- ☐ C) monetarist.
- ☐ D) soft landing.

Explanation

Keynesian economics is the body of economic thought that believes that active government intervention in the marketplace is the only method of insuring economic growth and stability, and that the government should manipulate the economy through adjusting levels of government expenditure and taxation. A monetarist economist is one that believes

that the manipulation of the money supply is the most important tool with regard to affecting the economy. These are the two major types of fiscal policy that basically advocate affecting the economy through manipulation of taxation and the spending policies of the federal government.

Reference: 14.1.2.1.1 in the License Exam Manual

Question #192 of 201

Question ID: 606933

Expansions in the business cycle are characterized by:

- ✓ **A)** increasing consumer demand for goods and services, increasing industrial production, and rising stock markets and property values.
- X **B)** higher consumer debt, rising inventories.
- X **C)** increasing college enrollments and enlistment in military service.
- X **D)** increase in want ads in newspapers, decrease in nonfarm jobs.

Explanation

Expansions in the business cycle are characterized by increasing consumer demand for goods and services, increasing industrial production, and rising stock markets and property values. Each of the remaining characterizations would more likely be associated with periods of contraction in the economic business cycle.

Reference: 14.1.1 in the License Exam Manual

Question #193 of 201

Question ID: 607043

If a company issues \$10 million in par value convertible debentures, all of the following balance sheet items will be affected EXCEPT:

- X **A)** working capital.
- X **B)** liabilities.
- ✓ **C)** net worth.
- X **D)** assets.

Explanation

Net worth is not affected by the issuance of long-term debt because it does not represent ownership. Assets will be affected (increased) by the issuance of long-term bonds. Liabilities will be affected (increased) by the amount of the issuance. Working capital will also increase.

Reference: 14.6.2 in the License Exam Manual

Question #194 of 201

Question ID: 607089

ABC, with 3 million shares outstanding, reports after-tax earnings of \$7.5 million. Annual cash dividends total \$1 per share. The dividend payout ratio is:

- ✓ **A)** 40%.
- X **B)** 33%.
- X **C)** 25%.
- X **D)** 20%.

Explanation

To compute this ratio, multiply the \$1 dividend by 3 million shares to get the total dividend paid of \$3 million. \$3 million is 40% of the \$7.5 million in earnings available to common.

Reference: 14.7.3.5 in the License Exam Manual

Question #195 of 201

Question ID: 607033

Which of the following analyze corporate financial statements and trends in sales and income?

- X **A)** Market timers.
- ✓ **B)** Fundamentalists.

- X **C)** Technicians.
- X **D)** Chartists.

Explanation

Fundamental analysts obtain information from corporate financial statements as well as other relevant sources. Technical analysts review market charts while fundamental analysts are concerned with the earnings ability of corporations derived from corporate financial statements.

Reference: 14.5 in the License Exam Manual

Question #196 of 201

Question ID: 607086

Which of the following characteristics *best* exemplifies a value stock?

- X **A)** Low earnings per share growth, high profitability.
- ✓ **B)** Low price-to-book, low price-to-earnings ratio.
- X **C)** High earnings per share growth, high profitability.
- X **D)** Low price-to-book, high price-to-earnings ratio.

Explanation

A value investor focuses on share price in anticipation of a market correction and improving company fundamentals. Therefore, such an investor tends to select a stock featuring lower price-to-earnings and price-to-book value ratios. A growth investor focuses on high earnings per share, growth, and high profitability.

Reference: 14.7.3.6 in the License Exam Manual

Question #197 of 201

Question ID: 606950

Wall Street closely monitors Federal Open Market Committee (FOMC) activities because of its effect on all of the following EXCEPT:

- X **A)** bank excess reserves.
- X **B)** interest rates.
- ✓ **C)** income tax rates.
- X **D)** money supply.

Explanation

The FOMC is one of the most influential committees in the Federal Reserve System, and its decisions affect the money supply, interest rates, and reserves that member banks must maintain. Their decisions do not affect income tax rates.

Reference: 14.2.1.2.1 in the License Exam Manual

Question #198 of 201

Question ID: 607078

Your customer wants to know what portion of earnings one of the companies held in her portfolio has available to pay interest expense on bonds the company currently has outstanding. You would be able to find this information

- ✓ **A)** on the firm's income statement indicated as earnings before interest and taxes (EBIT)
- X **B)** on a firm's income statement by subtracting preferred dividends from EBIT
- X **C)** on the firm's most recent balance sheet
- X **D)** by contacting the Internal Revenue Service (IRS)

Explanation

Earnings before interest and taxes (EBIT) is the amount of money a company has retained before paying taxes and interest on outstanding debt issues. This can be found by looking at the income statement for the company.

Reference: 14.6.3.1.1 in the License Exam Manual

Question #199 of 201

Question ID: 606963

Which of the following *most* quickly reflects changes in FRB policy?

- X **A)** The call money rate.
- X **B)** The prime rate.
- X **C)** The CD rate.
- ✓ **D)** The discount rate.

Explanation

The FRB has direct control of the discount rate. If the FRB changes policy, the discount rate is the key indicator.

Reference: 14.2.1.2.2 in the License Exam Manual

Question #200 of 201

Question ID: 607042

A corporation buys back its stock on the open market for all of the following reasons EXCEPT:

- X **A)** use it for stock options.
- X **B)** use it for future acquisitions.
- ✓ **C)** reduce interest charges.
- X **D)** increase earnings per share.

Explanation

The repurchase of common stock does not reduce interest payments; however, it does reduce total dividends paid.

Reference: 14.6.2.5 in the License Exam Manual

Question #201 of 201

Question ID: 607034

If one of your clients has recently bought several defensive stocks, she is probably anticipating:

- X **A)** a depression.
- X **B)** strong economic growth.
- ✓ **C)** a recession.
- X **D)** mild economic growth.

Explanation

Defensive stocks such as food company stocks do reasonably well in poor economic climates. If the client were anticipating a depression, the client would probably get out of equities and into high-quality short-term debt securities.

Reference: 14.5.1.1 in the License Exam Manual