Homework 5

> Gus Lipkin

1. Principal amount that the issuer is obligated to repay at maturity.
   - **Face value**
2. Dollar-denominated bonds sold outside the United States.
   - **Eurodollar bonds**
3. These bonds have their coupons reset every two or three years to reflect the current interest rate environment and any changes in the firm's credit quality.
   - **Extendable notes**
4. Which of the following types of stocks have the lowest risk to shareholders?
   - **cumulative preferred stock**
5. **Common stock** has the lowest claim on the assets and cash flow of the firm.
6. A **special dividend** is an extra dividend declared by the firm over and above its regular dividend payout.
7. The value of a share of stock, currently selling for $100, after it has a 2 for 1 split is $\frac{\$100}{2} = \$50$
8. What is a round lot of common stock?
   - **Sale or purchase of 100 shares**
9. Why does dividend income growth exceed that of bond income growth over a period of time?
   - **Stock values generally increase at higher rates than bonds can return.**
10. What is a capital gain? Is it taxed the same way as dividends?
    - **A capital gain is the increase in value of a stock. They are taxed differently from dividends because they are only taxed when stocks are sold, while dividends are taxed when distributed.**
11. When the market interest rate is the same as the coupon rate for a particular quality of bond, the bond will be priced **at its par value**.
12. When the market interest rate is above the coupon rate for a particular quality of bond, the bond will be priced **below its par value**.
13. When the market interest rate is below the coupon rate for a particular quality of bond, the bond will be priced **above its par value**.
14. A bond that is selling below par value.
    - **discount bond**
15. A bond that is selling in over its par value.
    - **premium bond**
16. A firm's stock is expected to pay a $3 annual dividend next year, the current stock price is $60, and the expected growth rate in dividends is 8 percent. Using the Gordon approach, what is the expected return? (Hint: Go over 10.8.2 – Under the Gordon Model)
    - $\frac{3}{60} + 8\% = 13\%$

17. According to the Gordon dividend model, which of the following variables would not affect a stock's price?
    - **the number of shares outstanding**
18. The value of a share of stock currently selling for $100 after it has a 5 for 1 split is $\frac{\$100}{5} = \$20$
19. Why are "junk bonds" also known as "high-yield bonds"?
    - **Junk bonds are also called high-yield bonds since the higher yield is needed to help offset any risk of default.**
20. Explain how a capital loss on the sale of a firm's stock can affect an investor's taxes.
    - **Capital losses make it possible for investors to recoup at least part of their losses on their tax returns by offsetting capital gains and other forms of income.**