

1. A corporation acquires new funds only when its securities are sold in the primary market by an investment bank.
2. When the borrower engages in activities that make it less likely that the loan will be repaid, moral hazard is said to exist.
3. The presence of transaction costs in financial markets explains, in part, why :
financial intermediaries and indirect finance play such an important role in financial markets.
4. Financial intermediaries :
 - 1.exist because there are substantial information and transaction costs in the economy.
 - 2.improve the lot of the small saver,
 3. are involved in the process of indirect finance.
5. Securities are assets for the person who buys them, but liabilities for the individual/firm that sells them.
6. U.S. dollars deposited in foreign banks outside the United States or in foreign branches of U.S. are referred to as Eurodollars
7. Which of the following can be described as involving direct finance?
A corporation buys commercial paper issued by another corporation.
8. The reduction in transaction costs per dollar of transactions as the size (scale) of transactions increases is known as economies of scale
9. Which of the following statements about financial markets and securities are **true**?
 - 1.Most common stocks are traded over-the-counter, although the largest corporations have their shares traded at organized stock exchanges such as the New York Stock Exchange.
 - 2.A corporation acquires new funds only when its securities are sold in the primary market.
 - 3.Money market securities are usually more widely traded than longer-term securities and so tend to be more liquid.
10. In financial markets, lenders typically have inferior information about potential returns and risks associated with any investment project. This difference in information is called asymmetric information.
11. The money market is the market in which short-term debt instruments are traded.
12. Which of the following statements about financial markets and securities are true?
A debt instrument is long term if its maturity is ten years or longer.
13. Intermediaries who are agents of investors and match buyers with sellers of securities are called
Brokers (*Brokers take no capital risk when they get involved in a securities transaction. They essentially match buyers and sellers. Traders, Dealers, Market-Makers (which are terms that can mean the same thing) risk the firm's capital when a client sells a security to them or buys a security from them. The term Investment Bankers often refers to Investment Bank professionals involved in Mergers & Acquisitions and/or Corporate Finance activity. Indeed, the M&A division of an Investment Bank is known as the 'Investment Banking Division' or IBD.)*
14. When the potential borrowers who are the most likely to default are the ones most actively seeking a loan, adverse selection is said to exist.
15. The presence of asymmetric information in financial markets leads to adverse selection and moral hazard problems that interfere with the efficient functioning of financial markets.

16. Which of the following are investment intermediaries?_
- Finance companies, mutual funds, pension funds. (Types of Financial Intermediaries
Financial Intermediaries act as middlemen. Finance companies act as middlemen...borrowing and lending. Mutual Funds act as middlemen acquiring small investments from private investors then investing in the financial markets. Pension Funds also act as middlemen: Workers save every month into their pension and the pension fund then invests (buys stocks/bonds) in the market. Note: Mutual Funds (a US term) are commonly known as Unit Trusts in the UK)
17. Which of the following can be described as involving direct finance? **None of the above**
- A corporation's stock is traded in an over-the-counter market.
People buy shares in a mutual fund.
A pension fund manager buys commercial paper in the secondary market.
An insurance company buys shares of common stock in the over-the-counter markets.
18. Which of the following can be described as involving indirect finance?
- a. A corporation takes out loans from a bank.
b. People buy shares in a mutual fund.
19. Which of the following markets is sometimes organized as an over-the-counter market?
- The stock market, the bond market, the foreign exchange market, the federal market .
20. The main sources of financing for businesses, in order of importance, are
issuing bonds, issuing stocks, financial intermediaries.
21. U.S. dollars deposited in foreign banks outside the United States or in foreign branches of U.S. are referred to as Eurodollars.
22. The concept of adverse selection helps to explain
why firms are more likely to obtain funds from banks and other financial intermediaries,
rather than from the securities markets, _
why direct finance is more important than indirect finance as a source of business finance.
23. Which of the following long-term bonds should have the highest interest rate?
- Corporate Baa bonds
24. The risk premium on corporate bonds becomes smaller if
the liquidity of corporate bonds increases.
the riskiness of corporate bonds decreases
25. Bonds with relatively high risk of default are called junk bonds.
26. A corporation suffering big losses might be more likely to suspend interest payments on its bonds, thereby raising the default risk and causing the demand for its bonds to fall
27. If a corporation begins to suffer large losses, then the default risk on its bonds will increase and the equilibrium interest rate on these bonds will increase.
28. The spread between the interest rates on bonds with default risk and default-free bonds, both of the same maturity, is called the risk premium.
29. If moody's or standard and Poor's downgrades its rating on a corporate bond, the demand for bond decreases and its yield increase.
30. When the corporate bond market becomes less liquid, other things equal, the demand curve for corporate bonds shifts to the left and the demand curve for Treasury bonds shifts to the right.

31. (I) If a corporate bond becomes less liquid, the interest rate on the bond will fall. **false**
 (II) If a corporate bond becomes less liquid, the interest rate on Treasury bonds will fall. **true**
32. When a municipal bond is given tax-free status, the demand for municipal bonds shifts leftward, causing the interest rate on the bond to fall.
33. The risk structure of interest rates is explained by: all above
default risk.
liquidity.
tax considerations.
34. When yield curves are steeply upward-sloping,
long-term interest rates are above short-term interest rates.
35. According to the expectations theory of the term structure interest rates on bonds of different maturities move together over time.
36. According to the expectations theory of the term structure,
A) when the yield curve is steeply upward-sloping, short-term interest rates are expected to rise in the future.
B) when the yield curve is downward-sloping, short-term interest rates are expected to decline in the future.
38. According to the market segmentation theory of the term structure,
A) the interest rate for bonds of one maturity is determined by the supply and demand for bonds of that maturity.
B) bonds of one maturity are not substitutes for bonds of other maturities; therefore, interest rates on bonds of different maturities do not move together over time.
C) investors' strong preference for short-term relative to long-term bonds explains why yield curves typically slope upward.
D) all of the above.
39. The liquidity premium theory of the term structure
 A) indicates that today's long-term interest rate equals the average of short-term interest rates that people expect to occur over the life of the long-term bond.
 B) assumes that bonds of different maturities are perfect substitutes.
 C) suggests that markets for bonds of different maturities are completely separate because people have different preferences.
D) does none of the above.
- 18) According to the liquidity premium theory of the term structure,
 A) the interest rate on long-term bonds will equal the average of short-term interest rates that people expect to occur over the life of the long-term bonds plus a liquidity premium.
 B) buyers of bonds may prefer bonds of one maturity over another, yet interest rates on bonds of different maturities move together over time.
 C) even with a positive liquidity premium, if future short-term interest rates are expected to fall significantly, then the yield curve will be downward sloping.
D) all of the above.
 E) only A and B of the above.

- 19) Compared to money market securities, capital market securities have
- A) more liquidity.
 - B) longer maturities.**
 - C) lower yields.
 - D) less risk.
- 20) I) Securities that have an original maturity greater than one year are traded in money markets.
false
- II) The best known money market securities are stocks and bonds. **False**
- 21)** (I) The primary issuers of capital market securities are federal and local governments, and corporations. **true**
- (II) Governments never issue stock because they cannot sell ownership claims. **true**
- 23) Bonds are securities that represent a debt owed by the issuer to the investor.
- 24) The face value of a bond is the amount that the issuer must pay at maturity.
- 24) The security with the longest maturity is a Treasury bond
- 25) Most of the time, the interest rate on Treasury notes and bonds is above that on money market securities because of interest rate risk.
- 26) Typically, the interest rate on corporate bonds will be lower the more restrictions are placed on management through restrictive covenants, because the bonds will be considered safer by buyers.
- 27) Long-term unsecured bonds that are backed only by the general creditworthiness of the issuer are called debentures.
- 28) When an old bond's market value is above its par value, the bond is selling at a premium. This occurs because the old bond's coupon rate is above the coupon rates of bonds with similar risk.
- 29) Restrictive covenants can
- A) limit the amount of dividends the firm can pay.
 - B) limit the ability of the firm to issue additional debt.
 - C) restrict the ability of the firm to enter into a merger agreement.
 - D) do all of the above.**
 - E) do only A and B of the above.
1. A strong dollar benefits American consumers and hurts American business.
 2. Increase demand for a country's export causes its currency to appreciate in the long run.
While increase demand for import causes its currency to depreciate.
 3. Best price for you can deal at?

EUR/USD:

Buy EUR, Sell USD = lowest offer

Sell EUR, Sell USD = highest bid

Week14

1. A negotiable certificate of deposit is a term security because it has a specified maturity date, a bearer instrument, meaning whoever holds the certificate at maturity receives the principal and interest, can be bought and sold until maturity.
2. An open market purchase leads to a expansion of reserves and deposit in the banking system and hence to a expansion of the monetary base and the money supply.
3. Investment rate=(worth n at maturity – pay at start)/ pay at start * 365/ maturity.
4. Which of the following money market instruments has the lowest rate : 4-week treasury bills.
5. If, as a financial professional, I believe us interest rates are going to gradually fall over the next two weeks, which investment strategies would it make sense to engage in?
Engage in a 14-days reverse repo and fund myself on an overnight basis (Correct. If I engage in a 14-day REVERSE REPO I buy the bonds in the first leg sell them in the second leg. I have effectively made a 14 day fixed rate loan. Suppose I do this at 2% for 14 days. If interest rates fall to 1% or 1.5% I can borrow that money I lent out at lower rates. I make a profit.)
6. Commercial paper securities are issued only by the largest and most creditworthy corporations, as they are unsecured, carry an interest rate that varies according to the firm's level of risk.
Never have a term to maturity that exceeds 270 days.
7. If the fed wants to lower the federal funds interest rate, it will add reserves the banking system by selling securities.
8. Unlike most money market securities, commercial paper is not generally traded in a secondary market.
9. Which of the following is the largest borrower in the money markets?
The U.S. Treasury
10. Federal funds are
 - i. usually overnight investments.
 - ii. borrowed by banks that have a deficit of reserves.
 - iii. lent by banks that have an excess of reserves.
11. Government securities dealers frequently engage in repos to
manage liquidity.
take advantage of anticipated changes in interest rates.
lend or borrow for a day or two with what is essentially a collateralized loan.

12. Eurodollars are time deposits with fixed maturities and are, therefore somewhat illiquid.
May offer borrower a lower interest rate than can be received in the domestic
marker.

Week 15

1. Stage two of a financial crisis in an advanced economy usually involves a banking crisis.
2. In an advanced economy, a financial crisis can begin in several ways, including:
 - Mismanagement of financial liberalization or innovation
 - Asset pricing booms and dusts
 - An increase in uncertainty caused by failure of financial institutions.
3. Which tranche of the CMO/CDO will pay the investor the highest interest rate?
Tranche D receives all monthly principal after Tranche C paid off.
(Part 3 - Mortgage Backed Securities - Page 215 'Mini Case'
Super Senior Tranche A = investors receive payment in full first so has least default risk
so lowest interest rate
Senior Tranche B = investors receive payments only after A has been paid so more risk
of default so higher interest rate then Tranche A
Mezzanine Tranche C = investors receive payments only after B has been paid so
more risk of default so higher interest rate then Tranche B
Equity Tranche D = investors receive payments after all other tranches so highest
default risk so highest interest rate offered on these bonds.)
4. From its peak in 1929 to the trough in December 1932, the Dow Jones industrial average fell
how much? 90%
5. Stage three of financial crisis in an advanced economy features ?
Debt deflation
6. What is a collateralized debt obligation?
A tranche of an SPV that has been setup based on default risk.
7. Financial crisis:
 - a. cause failures of financial intermediaries and leave only securities markets to channel
funds from savers to borrowers.
 - b. are a recent phenomenon that occur only in developing countries.
 - c. invariably lead to debt deflation.
 - d. all of the above.
 - e. none of the above.
8. The possibility that mortgages will prepay and force investors to seek alternative investments,
usually with lower expected returns, is called prepayment risk.
9. Debt deflation refers to a decline in net worth as price levels fall while debt burden remains
unchanged.

10. Which of the following factors led up to the Greece debt crisis in 2009-2010?
A decline in tax revenues resulting from a contraction in economic activity
A double-digit budget deficit
11. the process of deleveraging refers to
Cutbacks in leading by financial institutions.
13. Factors that lead to worsening conditions in financial markets include bank panics.
14. Which tranche of the CMO/CDO will pay the investor the highest interest rate?
Tranche D receives all monthly principal after Tranche C paid off.
(Super Senior Tranche A = investors receive payment in full first so has least default risk so lowest interest rate
Senior Tranche B = investors receive payments only after A has been paid so more risk of default so higher interest rate then Tranche A
Mezzanine Tranche C = investors receive payments only after B has been paid so more risk of default so higher interest rate then Tranche B
Equity Tranche D = investors receive payments after all other tranches so highest default risk so highest interest rate offered on these bonds)
15. When asset prices fall following a boom.
Moral hazard may increase in companies that have lost net worth in the bust.
Financial institutions may see the assets on their balance sheets deteriorate, leading to deleveraging.
16. Which following led to the us financial crisis of 2007-2009?
Financial innovation in mortgage markets
Agency problem in mortgage markets
17. During the early years of amortizing mortgage loan, the lender applies most of the monthly payment to interest on the loan.
18. In addition to having a direct effect on increasing adverse selection problems, increases in interest rates also promote financial crisis by increasing firm's and household' interest payments, thereby decreasing their cash flow.
19. the possibility that mortgages will prepay and force investor to seek alternative investments, usually with lower expected returns, is called prepayment risk.

Week 16

1. In 2020 the price of US oil, for immediate delivery, reached an all-time low of minus \$40 for the reason There was practically no storage capability with production still strong.
2. The average 'Fed Funds' rate over the last 40 years is 5.95%.
3. what is one of the hurdles in reporting post-trade date?
The amount of data that needs to analysed, stored and accessed.
4. Who are the big winners from MiFLD2: Technology providers and compliance firms.
5. MiFLD2 'research Unbundling' increase the cost of research for the buy side
6. Leading up to the 2020 Financial Crisis the Federal Reserve wished to 'normalise' interest rates because current interest rates left the Fed with little 'firepower'
7. The Volcker Rule in the US Prohibits depository banks from proprietary trading.

8. What is likely to be one of the big side effects on MiFID2? Market consolidation.
9. Basel 3 makes it more restrictive for investment banks to take trading positions.

Week17

1. Which type of open market operation is intended to change the level of reserves?
Dynamic open market operations.
2. Which of following is an element of the federal reserve system?
The federal reserve banks, the board of governors, the FOMC.
3. The strongest argument for an independent Federal Reserve rests on the view that subjecting the fed to more political pressures would impart an inflationary bias to monetary policy.
4. The discount rate is the interest rate on loans from the Fed to a bank.
5. A Federal Reserve open market purchase of bonds leads to No change in the banking system's balance sheet and no change in the Federal Reserve's balance sheet.
6. If the fed increase reserve requirements, the demand for reserve increase and the equilibrium federal funds rate rises.
7. If the fed wants to temporarily drain reserves from the banking system, it will engage in a REPO/ repurchase agreement.
8. Which if the following is true.
The Federal Reserve has a dual mandate focussing on price stability and full employment.
9. Under usual circumstances, an increase in the discount rate causes no change in the federal funds rate.
10. If the Federal Reserve wants to expand reserves in the banking system, it will purchase government securities.
11. The Federal Reserve will engage in an outright purchase if it wants to _____ reserves _____ in the banking system. increase; permanently
12. Consider a central bank policy to maintain 9% reserves on deposits held by commercial banks. A bank, ALFA, currently has \$10 million in deposits and holds \$1 million in reserves at the central bank. What is the excess reserve ratio? What will be the requirements if the bank is to add \$500,000 additional deposits?
Excess Reserve Ratio 1% and no additional reserve requirement
Solution: According to central bank requirements, ALFA needs to hold \$900,000 as reserves, but it has excess reserves of \$100,000.
Thus, total reserve = \$100,000 + \$900,000 = \$1,000,000.
Excess reserve ratio = 1%.
If the bank adds \$500,000 of additional deposits, the required reserve would become \$45,000. But the bank has \$1 million already as reserves. This means that no more required reserve is necessary.
13. The federal funds rate is the interest rate on loans of reserves from one bank to another.
14. Holding everything else constant, if the federal funds rate rises, then the demand for excess reserves falls because they have a higher cost.