Question #1 of 10

Question ID: 1551548

Which of the following is not a characteristic of a checklist approach as used in economic forecasting? A checklist approach:

A) requires subjective judgment.

B) may not be able to model complex relationships.

C) does not allow for changes in the model over time.

Explanation

A checklist approach actually allows for changes in the model over time.

(Module 1.2, LOS 1.e)

Question #2 of 10

Question ID: 1580636

Trish Plano is an analyst who uses the Grinold-Kroner model to forecast stock market returns. In one particular analysis, Plano estimates a 3.5% dividend yield, real earnings growth of 2.0%, long-term inflation of 2.0%, no increase in shares outstanding, and a 1.1% expansion of the P/E multiple. The implied return on the stock market given these assumptions should be *closest* to:

A) 8.6%.

B) 4.6%.

C) 8.2%.

Explanation

The Grinold-Kroner model states that the expected return of the stock market is its dividend yield, plus the inflation rate, plus the real earnings growth rate, minus the change in stock outstanding, plus changes in the P/E ratio:

$$\text{Return} = 3.5\% + 2.0\% + 2.0\% - 0\% + 1.1\% = 8.6\%.$$

(Module 2.3, LOS 2.c)

Question #3 of 10

Question ID: 1551594

Suppose that an equity market has a dividend yield of 3%, real earnings growth of 2%, inflation of 1%, and a 0.5% reduction in shares outstanding is anticipated. Furthermore, the P/E ratio is expected to rise from 16 to 16.32.

The return on the market that would be forecast by the Grinold-Kroner model would be *closest* to:

A) 7.5%.

B) 8.5%.

C) 6.0%.

Explanation

The forecasted return includes all the elements of Grinold-Kroner. The reduction in shares outstanding represents a repurchase yield and adds to the forecasted return. The increase in the P/E ratio would result in an additional return. Numerically, the return is computed as 3% + 2% + 1% − (−0.5%) +((16.32 / 16) − 1) = 8.5%.

(Module 2.3, LOS 2.c)

Question #4 of 10

Question ID: 1577674

Which of the following would indicate the *greatest* stimulation of economic growth?

A) Tax receipts increase due to a new government policy.

B) Tax receipts decline due to a new government policy.

C) Tax receipts increase due to changes in the economy.

Explanation

Only changes in the deficit directed by government policy will influence growth. A tax cut, which would result in lower tax receipts over the short term, would stimulate the economy. Changes in the deficit that occur naturally over the course of the business cycle are not stimulative or restrictive. In an expanding economy, deficits will decline because tax receipts increase and disbursements to the unemployed decrease. The opposite occurs during a recession.

(Module 1.4, LOS 1.h)

Question #5 of 10

Question ID: 1577671

Suppose that the Consumer Price Index is expected to change from 124 to 118. The asset class *most likely* to perform the best during such a period is:

A) real estate.

B) equity.

C) high-quality bonds.

Explanation

The inflation index forecast suggests that deflation is expected. Nominal rate bonds should perform the best under that scenario because the purchasing power of the coupon payments would increase. Given the high-quality nature of the bonds, concerns about default are unlikely to dominate this greater purchasing power benefit.

(Module 1.3, LOS 1.g)

Question #6 of 10

Question ID: 1577662

The use of appraisal data, relative to actual returns, results in correlations that are biased:

A) upward and standard deviations that are biased upward.

B) upward and standard deviations that are biased downward.

C) downward and standard deviations that are biased downward.

Explanation

The use of appraisal data, relative to actual returns, results in correlations that are biased downward and standard deviations that are biased downward. The reason is that price fluctuations are masked by the use of appraised data.

(Module 1.1, LOS 1.b)

Question #7 of 10

Question ID: 1580642

An analyst estimates the following statistics for properties in the commercial real estate sector:

- Current capitalization (cap) rate: 4.3%
- Next year's expected cap rate: 3.8%
- Net operating income (NOI) real growth rate: 1.2%
- Expected inflation: 0.9%

Based on the information provided, the expected return on the commercial real estate sector properties is *closest* to:

A) −0.6%.

B) 18.0%.

C) 5.9%.

Explanation

The change in expected cap rate from 4.3% to 3.8% represents an 11.6% decrease (3.8% − 4.3%) / 4.3% = −11.6%.

The expected return on the commercial real estate properties can be written as:

$E(R_{RE})$ = cap rate + nominal NOI growth rate − %Δcap rate = 4.3% + (1.2% + 0.9%) − (−11.6%) = 18.0%.

(Module 2.5, LOS 2.e)

Question #8 of 10

Question ID: 1580643

Joshua Petersen is a real estate analyst who wants to make appropriate adjustments to a capitalization rate. He predicts that vacancy rates will increase and that the availability of credit will decrease. Based on these views, it is *most likely* that Petersen:

A) should increase the capitalization rate.

B) should decrease the capitalization rate.

C) may need to either increase or decrease the capitalization rate because the two predictions have offsetting effects.

Explanation

Capitalization rates are positively related to vacancy rates and inversely related to the availability of credit. Therefore, the appropriate adjustment to the capitalization rate would be to increase it. This is logical because both factors should negatively impact the value of real estate, which would also be the result of using a higher capitalization rate.

(Module 2.5, LOS 2.e)

Question #9 of 10

Question ID: 1551620

During which phase of the business cycle would TIPS be *least* useful to a portfolio manager?

A) Initial recovery.

B) Early expansion.

C) Slowdown.

Explanation

U.S. Treasury Inflation Protected Securities (TIPS) are protected against increases in inflation. They would be needed the least when inflation is falling. During the initial recovery phase of the business cycle, inflation is falling.

(Module 2.8, LOS 2.h)

Question #10 of 10

Question ID: 1551547

Which of the following is not a characteristic of economic indicators as used in economic forecasting? Economic indicators:

A) can be adapted for specific purposes.

B) are difficult to understand and interpret.

C) have an effectiveness that has been verified by academic research.

Explanation

Economic indicators are actually easy to understand and interpret.

(Module 1.2, LOS 1.e)