Chapter 3

1. Under firm-commitment underwriting, the ______ assumes the full risk that the shares cannot be sold to the public at the stipulated offering price.
A. red herring
B. issuing company
C. initial stockholder
D. underwriter

2. Private placements can be advantageous, compared to public issue, because:
I. Private placements are cheaper to market than public issues.
II. Private placements may still be sold to the general public under SEC Rule 144A.
III. Privately placed securities trade on secondary markets.
A. I only
B. I and III only
C. II and III only
D. I, II, and III

3. The margin requirement on a stock purchase is 25%. You fully use the margin allowed to purchase 100 shares of MSFT at $25. If the price drops to $22, what is your percentage loss?
A. 9%
B. 15%
C. 48%
D. 57%

4. Rank the following types of markets from least integrated and organized to most integrated and organized:
I. Brokered markets
II. Continuous auction markets
III. Dealer markets
IV. Direct search markets
A. IV, II, I, III
B. I, III, IV, II
C. II, III, IV, I
D. IV, I, III, II

5. Which one of the following types of markets requires the greatest level of trading activity to be cost-effective?
A. broker market
B. dealer market
C. continuous auction market
D. direct search market

6. The term inside quotes refers to ______.
A. the difference between the lowest bid price and the highest ask price in the limit orderE. book.
B. the difference between the highest bid price and the lowest ask price in the limit order book.
C. the difference between the lowest bid price and the lowest ask price in the limit order book.
D. the difference between the highest bid price and the highest ask price in the limit order book.

7. If an investor places a __________ order, the stock will be sold if its price falls to the stipulated level. If an investor places a ___________order, the stock will be bought if its price rises above the stipulated level.
A. stop-buy; stop-loss
B. market; limit
C. stop-loss; stop-buy
D. limit; market

8. On a given day a stock dealer maintains a bid price of $1,000.50 for a bond and an ask price of $1003.25. The dealer made 10 trades that totaled 500 bonds traded that day. What was the dealer’s gross trading profit for this security?
A. $1,375
B. $500
C. $275
D. $1,450

9. The over-the-counter securities market is a good example of __________.
A. an auction market
B. a brokered market
C. a dealer market
D. a direct search market

10. You find that the bid and ask prices for a stock are $10.25 and $10.30 respectively. If you purchase or sell the stock you must pay a flat commission of $25. If you buy 100 shares of the stock and immediately sell them, what is your total implied and actual transaction cost in dollars?

A. $50

B. $25

C. $30

D. $55

11. Which of the following are true concerning short sales of exchange listed stocks?

I. A short sale is permitted only if the last recorded change in the stock's price was positive

II. Proceeds from the short sale must be kept on deposit with the broker

III. Short-sellers must post margin with their broker to cover potential losses on the position

IV. The short-seller earns interest on any cash deposited with the broker that is used to meet the margin requirement

A. I and II only

B. I, III and IV only

C. II and III only

D. I, II, III and IV

12. What was the result of high-frequency traders' leaving the market during the flash crash of 2010?

A. Market liquidity decreased.

B. Market liquidity increased.

C. Market volatility decreased.

D. Trading frequency increased.

13. Assume you purchased 500 shares of XYZ common stock on margin at $40 per share from your broker. If the initial margin is 60%, the amount you borrowed from the broker is _________.

A. $20,000

B. $12,000

C. $8,000

D. $15,000

14. You purchased 250 shares of common stock on margin for $25 per share. The initial margin is 65% and the stock pays no dividend. Your rate of return would be __________ if you sell the stock at $32 per share. Ignore interest on margin.
A. 35%
B. 39%
C. 43%
D. 28%

15. You hold 5,000 shares of the 1 million outstanding shares of Wealthy Wranglers common stock. You've just learned that the company plans to issue more shares, so that 2 million shares will be outstanding. This is called _____.
A. an advanced equity offering
B. a weathered equity offering
C. a seasoned equity offering
D. a veteran equity offering

16. Trading on inside information is:
I. Prohibited by federal law
II. Prohibited by the CFA Institute Standards of Professional Conduct
III. Monitored by the SEC
A. I and II only
B. II and III only
C. I and III only
D. I, II, and III

17. The term "underwriting syndicate" describes _______.
A. the issuing firm
B. the lead underwriter
C. the investment banks that participate in the underwriting
D. the private investors that purchase the shares

18. You purchased XYZ stock at $50 per share. The stock is currently selling at $65. Your gains could be protected by placing a _________.
A. limit buy order
B. limit sell order
C. market order
D. stop-loss (or stop-buy) order

19. The average depth of the limit order book is _____.

A. lower for the large stocks in the S&P 500 Index than for the smaller stocks in the Russell 2000 Index

B. higher for the large stocks in the S&P 500 Index than for the smaller stocks in the Russell 2000 Index

C. about the same for both the large stocks in the S&P 500 Index and the smaller stocks in the Russell 2000 Index

D. unrelated to the sizes of the stocks in the indexes

20. In ________ markets, participants post bid and ask prices at which they are willing to trade, but orders are not automatically executed by computer. ____________ execute trades for people other than themselves, and in _______________ markets a computer matches orders with an existing limit order book and executes the trades automatically.

A. electronic; Dealers; brokers

B. dealer; Brokers; electronic

C. direct search; Brokers; electronic

D. brokered; Dealers; direct search

21. You short-sell 200 shares of Rock Creek Fly Fishing Co., now selling for $50 per share. If you wish to limit your loss to $2,500, you should place a stop-buy order at ____.

A. $37.50

B. $62.50

C. $56.25

D. $59.75

22. An investor puts up $5,000 but borrows an equal amount of money from their broker to double the amount invested to $10,000. The broker charges 7% on the loan. The stock was originally purchased at $25 per share and in one year the investor sells the stock for $28. The investor's rate of return was ____.

A. 17%

B. 12%

C. 14%

D. 19%

23. You sell short 200 shares of Doggie Treats Inc. which are currently selling at $25 per share. You post the 50% margin required on the short sale. If your broker requires a 30% maintenance margin, at what stock price will you get a margin call? (You earn no interest on the funds in your margin account and the firm does not pay any dividends)

A. $28.85

B. $35.71

C. $31.50

D. $32.25

24. You short-sell 200 shares of Tuckerton Trading Co., now selling for $50 per share. What is your maximum possible gain ignoring transactions cost?

A. $50

B. $150

C. $10,000

D. unlimited

25. Initial public offerings (IPOs) are usually ___________ relative to the levels at which their prices stabilize after they begin trading in the secondary market.

A. over priced

B. correctly priced

C. under priced

D. mispriced but without any particular bias

1	2	3	4	5
D	A	C	D	C
6	7	8	9	10
B	C	A	C	D
11	12	13	14	15
C	A	C	C	C
16	17	18	19	20
D	C	D	B	B
21	22	23	24	25
B	A	A	C	C

3. $(\$25 - \$22) \div 0.25 \times \$25 \times 100 = 0.48 = 48\%$

8. $(\$1{,}003.25 - \$1{,}000.50) \times 500 = \$1{,}375$

10. $100 \times (\$10.30 - \$10.25) + 2 \times (\$25 \div 100) = \$55$

13. $500 \times \$40 \times 0.40 = \$8{,}000$

14. $(\$32 - \$25) \div (\$25 \times 0.65) = 0.43$

21. $\$50 + (\$2{,}500 \div 200) = \$62.50$

22. The investor buys 400 (= \$10,000 ÷ \$25) shares.
    The 400 shares worth $400 \times \$28 = \$11{,}200$
    The profit = $\$11{,}200 - 1.07 \times \$5{,}000 = \$5{,}850$
    Rate of return = $(\$5{,}850 - \$5{,}000) \div \$5{,}000 = 0.17 = 17\%$

23. The asset value of the account = $200 \times \$25 + 200 \times \$25 \times 0.5 = \$7{,}500$
    The equity value of the account = $\$7{,}500 - 200 \times$ the margin call price (P)
    The short position margin ratio = $(\$7{,}500 - 200P) / 200P = 0.3 \Rightarrow P = \$28.85$

24. Tuckerton could go bankrupt with a share price of \$0. You could keep the entire proceeds from the short sale.
    Maximum gain = $200 \times \$50 - 200 \times \$0 = \$10{,}000$