Chapter 2

1. A dollar-denominated deposit at a London bank is called _____.
A. eurodollars
B. LIBOR
C. fed funds
D. bankers'’acceptance

2. Money market securities are sometimes referred to as *cash equivalents* because _____.
A. they are safe and marketable
B. they are not liquid
C. they are high risk
D. they are low-denomination

3. An investor in a T-bill earns interest by _________.
A. receiving interest payments every 90 days
B. receiving dividend payments every 30 days
C. converting the T-bill at maturity into a higher-valued T-note
D. buying the bill at a discount from the face value to be received at maturity

4. Which one of the following is a true statement?
A. Dividends on preferred stocks are tax-deductible to individual investors but not to corporate investors.
B. Common dividends cannot be paid if preferred dividends are in arrears on cumulative preferred stock.
C. Preferred stockholders have voting power.
D. Investors can sue managers for nonpayment of preferred dividends.

5. The bid price of a Treasury bill is _________.
A. the price at which the dealer in Treasury bills is willing to sell the bill
B. the price at which the dealer in Treasury bills is willing to buy the bill
C. greater than the ask price of the Treasury bill expressed in dollar terms
D. the price at which the investor can buy the Treasury bill

6. Which of the following is *not* a true statement regarding municipal bonds?
A. A municipal bond is a debt obligation issued by state or local governments.
B. A municipal bond is a debt obligation issued by the federal government.
C. The interest income from a municipal bond is exempt from federal income taxation.
D. The interest income from a municipal bond is exempt from state and local taxation in the issuing state.

7. An individual who goes short in a futures position _____.
A. commits to delivering the underlying commodity at contract maturity
B. commits to purchasing the underlying commodity at contract maturity
C. has the right to deliver the underlying commodity at contract maturity
D. has the right to purchase the underlying commodity at contract maturity

8. A bond that has no collateral is called a _________.
A. callable bond
B. debenture
C. junk bond
D. mortgage

9. A T-bill quote sheet has 90-day T-bill quotes with a 4.92 bid and a 4.86 ask. If the bill has a $10,000 face value, an investor could buy this bill for ____.
A. $10,000
B. $9,878.50
C. $9,877
D. $9,880.16

10. Which one of the following is a true statement regarding corporate bonds?
A. A corporate callable bond gives its holder the right to exchange it for a specified number of the company's common shares
B. A corporate debenture is a secured bond.
C. A corporate convertible bond gives its holder the right to exchange it for a specified number of the company's common shares.
D. Holders of corporate bonds have voting rights in the company.

11. An investor buys a T-bill at a bank discount quote of 4.80 with 150 days to maturity. The investor's bond equivalent yield on this investment is

A. 4.8%

B. 4.97%

C. 5.47%

D. 5.74%

12. A __________ gives its holder the right to buy an asset for a specified exercise price on or before a specified expiration date.

A. call option

B. futures contract

C. put option

D. interest rate swap

13. A firm that has large securities holdings and wishes to raise money for a short length of time may be able to find the cheapest financing from which of the following?

A. reverse repurchase agreement

B. bankers' acceptance

C. commercial paper

D. repurchase agreement

14. An investor purchases one municipal bond and one corporate bond that pay rates of return of 5% and 6.4%, respectively. If the investor is in the 15% tax bracket, his after-tax rates of return on the municipal and corporate bonds would be, respectively, _____.

A. 5% and 6.4%

B. 5% and 5.44%

C. 4.25% and 6.4%

D. 5.75% and 5.44%

15. The price quotations of Treasury bonds in the Wall Street Journal show a bid price of 104.5313 and an ask price of 104.5489. If you sell a Treasury bond, you expect to receive _________.

A. $ 1,000.00

B. $ 1,045.00

C. $ 1,045.31

D. $ 1,045.48

16. Investors will earn higher rates of returns on TIPS than on equivalent default-risk standard bonds if _______________.

A. inflation is lower than anticipated over the investment period
B. inflation is higher than anticipated over the investment period
C. the U.S. dollar increases in value against the euro
D. the spread between commercial paper and Treasury securities remains low

17. Which of the following does not approximate the performance of a buy-and-hold portfolio strategy?

A. an equally weighted index
B. a price-weighted index
C. a value-weighted index
D. all of these options (Weights are not a factor in this situation.)

18. A bond issued by the state of Alabama is priced to yield 6.25%. If you are in the 28% tax bracket, this bond would provide you with an equivalent taxable yield of

A. 4.5%
B. 7.25%
C. 8.68%
D. none of these options

19. June call and put options on King Books Inc. are available with exercise prices of $30, $35, and $40. Among the different exercise prices, the call option with the _____ exercise price and the put option with the _____ exercise price will have the greatest value.

A. $40; $30
B. $30; $40
C. $35; $35
D. $40; $40

20. The ________ the ratio of municipal bond yields to corporate bond yields, the _________ the cutoff tax bracket at which more individuals will prefer to hold municipal debt.

A. higher; lower
B. lower; lower
C. higher; higher
D. The answer cannot be determined without more information.

21. Large well-known companies often issue their own short-term unsecured debt notes directly to the public, rather than borrowing from banks; their notes are called
A. certificates of deposit
B. repurchase agreements
C. bankers' acceptances
D. commercial paper

22. If you thought prices of stock would be rising over the next few months, you might want to __________________ on the stock.
A. purchase a call option
B. purchase a put option
C. sell a futures contract
D. place a short-sale order

23. A stock quote indicates a stock price of \$60 and a dividend yield of 3%. The latest quarterly dividend received by stock investors must have been ______ per share.
A. \$0.55
B. \$1.80
C. \$0.45
D. \$1.25

24. A corporation in a 34% tax bracket invests in the preferred stock of another company and earns a 6% pretax rate of return. An individual investor in a 15% tax bracket invests in the same preferred stock and earns the same pretax return. The after-tax return to the corporation is _______, and the after-tax return to the individual investor is _______.
A. 3.96%; 5.1%
B. 5.39%; 5.1%
C. 6%; 6%
D. 3.96%; 6%

25. A benchmark index has three stocks priced at \$23, \$43, and \$56. The number of outstanding shares for each is 350,000 shares, 405,000 shares, and 553,000 shares, respectively. If the market value weighted index was 970 yesterday and the prices changed to \$23, \$41, and \$58 today, what is the new index value?
A. 960
B. 970
C. 975
D. 985

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

9. $10,000 × (1 – 0.0486 × 90/360) = $9,878.50

10. $10,000 × (1 – 0.048 × 150/360) = $9,800
    ($10,000/$9,800) – 1 = 0.020408 = 2.0408%
    2.0408% × (365/150) = 4.97%

14. After-tax rate of return on the corporate bond = 6.4% × (1 – 15%) = 5.44%

18. 6.25% / (1 – 28%) = 8.68%

23. Annual cash dividend = $60 × 3% = $1.8
    Quarterly cash dividend = $1.8 / 4 = $0.45

24. Corporation: 6% × 0.7 + 6% × 0.3 × (1 – 34%) = 5.39%
    Individual: 6% × (1 – 15%) = 5.1%

25. Weight on stock A = ($23 × 350,000) ÷ ($23 × 350,000 + $43 × 405,000 + $56 × 553,000) = 0.14
    Weight on stock B = ($43 × 405,000) ÷ ($23 × 350,000 + $43 × 405,000 + $56 × 553,000) = 0.31
    Weight on stock C = ($56 × 553,000) ÷ ($23 × 350,000 + $43 × 405,000 + $56 × 553,000) = 0.55
    One-day return on stock A = ($23 – $23) / $23 = 0%
    One-day return on stock B = ($41 – $43) / $43 = -4.65%
    One-day return on stock C = ($58 – $56) / $56 = 3.57%

One-day return on the index = $0.14 \times 0\% + 0.31 \times (-4.65\%) + 0.55 \times 3.57\% = 0.52\%$

New index value = $970 \times (1 + 0.52\%) = 975$