Chapter 8

1. The weak form of the EMH states that ________ must be reflected in the current stock price.
A. all past information, including security price and volume data
B. all publicly available information
C. all information, including inside information
D. all costless information

2. The semistrong form of the EMH states that ________ must be reflected in the current stock price.
A. all security price and volume data
B. all publicly available information
C. all information, including inside information
D. all costless information

3. The strong form of the EMH states that ________ must be reflected in the current stock price.
A. all security price and volume data
B. all publicly available information
C. all information, including inside information
D. all costless information

4. Random price movements indicate ________.
A. irrational markets
B. that prices cannot equal fundamental values
C. that technical analysis to uncover trends can be quite useful
D. that markets are functioning efficiently

5. The tendency when the ______ performing stocks in one period are the best performers in the next and the current ________ performers are lagging the market later is called the reversal effect.
A. worst; best
B. worst; worst
C. best; worst
D. best; best

6. You believe that you can earn 2% more on your portfolio if you engage in full-time stock research. However, the additional trading costs and tax liability from active management will cost you about .5%. You have an $800,000 stock portfolio. What is the most you can afford to spend on your research?
A. $4,000
B. $8,000
C. $12,000
D. $16,000

7. Even if the markets are efficient, professional portfolio management is still important because it provides investors with:
I. Low-cost diversification
II. A portfolio with a specified risk level
III. Better risk-adjusted returns than an index
A. I only
B. I and II only
C. II and III only
D. I, II, and III

8. If the U.S. capital markets are not informationally efficient, ______.
A. the markets cannot be allocationally efficient
B. systematic risk does not matter
C. no type of analysis can be used to generate abnormal returns
D. returns must follow a random walk

9. "Active investment management may at times generate additional returns of about .1%. However, the standard deviation of the typical well-diversified portfolio is about 20%, so it is very difficult to statistically identify any increase in performance." Even if true, this statement is an example of the _________ problem in deciding how efficient the markets are.
A. Magnitude
B. selection bias
C. lucky event
D. allocation

10. Most tests of semistrong efficiency are _________.

A. designed to test whether inside information can be used to generate abnormal returns
B. based on technical trading rules
C. unable to generate any evidence of market anomalies
D. joint tests of market efficiency and the risk-adjustment measure

11. The effect of liquidity on stock returns might be related to:

I. The small-firm effect
II The book-to-market effect
III The neglected-firm effect
IV. The P/E effect

A. I and II only
B. I and III only
C. II and IV only
D. I, II, and III only

12. The term random walk is used in investments to refer to ______________.

A. stock price changes that are random but predictable
B. stock prices that respond slowly to both old and new information
C. stock price changes that are random and unpredictable
D. stock prices changes that follow the pattern of past price changes

13. Stock market analysts have tended to be ___________ in their recommendations to investors.

A. slightly overly optimistic
B. overwhelmingly optimistic
C. slightly overly pessimistic
D. overwhelmingly pessimistic

14. Which of the following contradicts the proposition that the stock market is weakly efficient?

A. Over 25% of mutual funds outperform the market on average.
B. Insiders earn abnormal trading profits.
C. Every January, the stock market earns above-normal returns.
D. Applications of technical trading rules fail to earn abnormal returns.

15. One type of passive portfolio management is ________.
A. investing in a well-diversified portfolio without attempting to search out mispriced securities
B. investing in a well-diversified portfolio while only seeking out passively mispriced securities
C. investing an equal dollar amount in index stocks
D. investing in an equal amount of shares in each of the index stocks

16. A technical analyst is most likely to be affiliated with which investment philosophy?
A. active management
B. buy and hold
C. passive investment
D. index funds

17. Insiders are able to profitably trade and earn abnormal returns prior to the announcement of positive news. This is a violation of which form of efficiency?
A. weak-form efficiency
B. semistrong-form efficiency
C. strong-form efficiency
D. technical analysis

18. The tendency of poorly performing stocks and well-performing stocks in one period to continue their performance into the next period is called the ________________.
A. fad effect
B. martingale effect
C. momentum effect
D. reversal effect

19. When testing mutual fund performance over time, one must be careful of ___________, which means that a certain percentage of poorer-performing funds fail over time, making the performance of remaining funds seem more consistent over time.
A. survivorship bias
B. lucky event bias
C. magnitude bias
D. mean reversion bias

20. The primary objective of fundamental analysis is to identify __________.

A. well-run firms

B. poorly run firms

C. mispriced stocks

D. high P/E stocks

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

5.

(.02 - .005)($800,000) = $12,000