**FIN 346 EXAM 1 MC REVIEW**

**Chapters 1, 2**

* 1. What are types of financial assets (securities)?

Check all that apply:

**Bonds**

**Derivatives**

Real estate

**Stocks**

* 1. \_\_\_\_\_ assets are used to produce products or services, while \_\_\_\_\_ assets are claims on real assets or on the cash flows they produce.

Financial; real

Financial; tangible

**Real; financial**

Tangible; real

NOTES: Real assets are used to produce products or services, while financial assets are claims on real assets or on the cash flows they produce.

Real assets produce real products or services, thus increasing wealth. Financial assets, on the other hand, determine how the additional income or wealth are distributed between investors.

* 1. Which of the following are real assets?

Check all that apply:

Corporate bond

**Factory**

**Machine**

**Patent**

**Plot of land**

* 1. A derivative is \_\_\_\_\_.

a call option

a copy-cat security

a piece of work derived from some other piece of work

**any security whose value is derived from the value of some other asset**

**NOTES:** A call option is an example of a derivative, but not all derivatives are call options.

* 1. Which are functions of financial markets?

Check all that apply:

**Consumption timing**

**Resource allocation**

**Risk allocation**

**NOTES:** Maturity intermediation is done by financial institutions, such as commercial banks. Financial markets, on the other hand, help savers shift consumption to the future and borrowers shift consumption to the present, allocate capital resources to the companies with the best opportunities, shift risk to investors most willing to bear it, and facilitate the separation of ownership and management by allowing investors to trade their claims with each other.

* 1. In general, an asset with higher expected return \_\_\_\_\_.

is less expensive

is more expensive

has lower risk

**has higher risk**

**NOTES:** The risk-return trade-off implies that a higher expected return goes hand-in-hand with higher risk.

* 1. Which of the following is a primary market transaction?

A pension fund buys 80,000 shares of Facebook stock from another fund with the help of an investment bank.

**Apple issues one million shares of new stock and sells them to the public with the help of an investment bank.**

You buy 100 shares of Twitter stock from your friend, exchanging cash for shares.

You buy 100 shares of Twitter stock, with your broker routing the order to the NYSE.

**NOTES:** In a primary market transaction, a company issues (creates) new securities by selling them to investors for the first time.

1. You just logged into your online brokerage account and bought 100 shares of Apple stock. This is an example of \_\_\_\_\_.

a money market transaction

a primary market transaction

**a secondary market transaction**

an over-the-counter transaction

* 1. \_\_\_\_\_ are markets in which financial securities are issued for the first time, while \_\_\_\_\_ are markets where already existing securities are traded.

Issue markets; liquidity markets

Issue markets; secondary markets

Primary markets; liquidity markets

**Primary markets; secondary markets**

**NOTES:** Primary markets are used by companies to raise new capital. They issue (create) new stocks or bonds and sell them to investors. If these securities are offered to everyone (a public offering), the transaction is called an initial public offering (IPO).

Secondary markets allow investors to trade existing securities with each other. The New York Stock Exchange and NASDAQ are examples of a secondary market. The issuer of the security does not receive any money from secondary market transactions.

* 1. \_\_\_\_\_ are the markets for short-term debt securities, while \_\_\_\_\_ are the markets for long-term debt securities and stocks.

Credit markets; capital markets

Credit markets; stock markets

**Money markets; capital markets**

Money markets; stock markets

NOTES: Short-term debt securities, such as treasury bills and certificates of deposit, are said to trade in the money market. Long-term debt securities, such as treasury notes and bonds, commercial and municipal bonds, and stocks trade in the capital market.

Securities with a time to maturity of up to one year are considered money market instruments, while securities with a time to maturity of more than one year, or no maturity date at all (like stocks), are considered capital market instruments.

* 1. Which of the following are money market instruments?

Check all that apply:

**Certificates of deposit**

**Commercial paper**

Municipal bonds

**Treasury bills**

**NOTES:** Bonds, including municipal bonds, have maturities longer than one year, and are thus not considered money market instruments.

* 1. Which statements are true about Treasury bills (T-bills)?

Check all that apply:

Historically, T-bills have consistently paid a risk premium over CDs.

**Investors buy T-bills at a discount from the stated maturity value**.

**T-bills are the most marketable of all market securities.**

**The income earned on T-bills is exempt from all state and local taxes.**

* 1. If the state of California issues a bond, it is called a \_\_\_\_\_.

corporate bond

**municipal bond**

state bond

Treasury bond

* 1. Municipal bonds are bonds issued by \_\_\_\_\_.

the federal government

corporations

**state and local governments**

non-profit organizations

* 1. Municipal bonds are different from corporate bonds in that \_\_\_\_\_.

they are issued by the federal government

**their interest is exempt from federal taxes**

they do not have default risk

they are more liquid

* 1. Which are rights of common stockholders?

Check all that apply:

**The right to vote on major decisions at the annual general meeting**

The right to receive regular dividends

**The right to a share of dividends paid**

**The right to vote for members of the board of directors**

* 1. Preferred stock is like long-term debt since both \_\_\_\_\_, but preferred stock also resembles equity since both \_\_\_\_\_.

are tax-deductible expenses for the firm; have no definite maturity date

have a finite maturity date; have unlimited upside potential

**make regular, fixed payments; don't guarantee dividend payments**

rank above common stock in the priority of claims; grant voting rights to the stockholder

* 1. Preferred stock often has a yield below that of the company's long-term bonds because \_\_\_\_\_.

bonds are riskier

bonds rank higher in the priority of claims

**corporations can exclude most dividends received from taxable income**

dividends can be suspended, but not interest payments

* 1. Which of the following is true about American Depository Receipts (ADRs)?

They are certificates traded in foreign markets and represent an ownership interest in a U.S company.

**They are certificates traded in U.S markets and represent an ownership interest in a foreign company.**

They are time deposits with a U.S bank, and are highly marketable securities.

They are dollar-denominated deposits at foreign banks.

* 1. A market value-weighted index is the \_\_\_\_\_\_. A good example of market value-weighted index is the \_\_\_\_\_\_\_.

average computed by adding the prices of the stocks and dividing by a "divisor"; Standard & Poor's Composite 500

simple average of the returns of each stock in an index; Dow Jones Industrial Average

simple average of the returns of each stock in an index; Standard & Poor's Composite 500

weighted average of the returns of each component security, with weights proportional to outstanding market value; Dow Jones Industrial Average

**weighted average of the returns of each component security, with weights proportional to outstanding market value; Standard & Poor's Composite 500**

* 1. Which security should sell at a greater price?

Check all that apply:

A 20-year Treasury bond with a 5% coupon rate.

**A 20-year Treasury bond with a 7% coupon rate.**

* 1. Which of the following indices has the broadest coverage of US listed securities?

Check all that apply:

Dow Jones Industrial Average

S&P 500

**Wilshire 5000**

**Chapter 3**

* 1. Financial industry regulatory authority (FINRA) is a \_\_\_\_\_\_ regulator, and its mission is \_\_\_\_\_\_\_

government; fostering of investor protection and market integrity

government; to give investor a clearer view of investment prospects

government; to protect investors from losses if their brokerage firms fail

**non-government; fostering of investor protection and market integrity**

non-government; to protect investors from losses if their brokerage firms fail

* 1. What is a primary market for stocks?

Electronic communication networks (ECNs)

NASDAQ

**The IPO and SEO markets**

The New York Stock Exchange

NOTES:Primary market transactions are transactions in which securities are newly issued, or created by the company. These transactions include initial public offerings (IPOs) and seasoned equity offerings (SEOs).

* 1. Selling stocks to the investing public for the first time is called a/an \_\_\_\_\_, while selling additional shares at a later date is called a/an \_\_\_\_\_.

public sale; follow-up sale

private placement; public offering

**initial public offering; seasoned equity offering**

first-time offering; follow-up offering

NOTES: Selling stocks to the investing public for the first time is called an initial public offering (IPO), while selling additional shares at a later date is called a seasoned equity offering (SEO).

* 1. A procedure in which the underwriter (investment bank) enters into a written agreement with the issuer of the securities to purchase the securities and then to resell them to the public is called \_\_\_\_\_ underwriting.

**firm commitment**

prospectus

best efforts

dutch auction

seasoned equity offering

* 1. Market orders get executed \_\_\_\_\_ at \_\_\_\_\_.

whenever the stock price goes above the limit; the current price in the market

whenever the stock price goes below the limit; the limit price

**immediately; the current price in the market**

immediately; the limit price

* 1. A limit order has \_\_\_\_\_.

price uncertainty and execution uncertainty

price uncertainty, but not execution uncertainty

**execution uncertainty, but not price uncertainty**

neither price uncertainty nor execution uncertainty

* 1. Which are costs of trading a security?

Check all that apply:

**Broker's commission**

**Dealer's bid-ask spread**

Flotation costs

**The price concession an investor may be forced to make for trading in quantities greater than those associated with the bid-ask quote**

**NOTES:** Flotation costs are incurred by a company when it issues new securities; they are not trading costs.

* 1. Which of the following statements are true about buying on margin?

Check all that apply:

The margin in the account represents the portion of the purchase which is borrowed from the broker.

**Limitations on the maintenance margin are set by the SEC.**

**Buying on margin means the investor buys securities using funds borrowed from his broker.**

Limitations on the initial margin are set by the Federal Reserve System.

NOTES: Buying on margin means the investor buys securities using funds borrowed from his broker. At the time of the purchase, the margin in the account represents the portion of the purchase which is contributed by the investor.

Limitations on the initial margin are set by the Board of Governors of the Federal Reserve System. Limitations on the maintenance margin are set by FINRA, but each brokerage firm can impose more stringent maintenance margin requirements.

**Chapter 5**

* 1. The risk premium is \_\_\_\_\_.

Check all that apply:

**the reward for bearing risk**

normally zero for risky assets

**normally positive for risky assets**

**the**

1. What might be reasons that corporate bonds earn higher returns than Treasury bills on average?

Check all that apply:

**Corporate bonds are less liquid.**

**Corporate bonds are less safe.**

Corporate bonds are subject to double taxation.

**Corporate bonds have a longer investment horizon.**

* 1. The real rate of interest equals \_\_\_\_\_.

the effective annual rate

the nominal interest rate

**the nominal interest rate adjusted for inflation**

the relative change in purchasing power

* 1. The slope of the capital allocation line is called the \_\_\_\_\_.

capital allocation slope

capital allocation ratio

**Sharpe ratio**

variability-to-reward ratio

* 1. The capital allocation line through the risk-free asset and a broad index of common stocks is called the \_\_\_\_\_.

capital allocation line

**capital market line**

index line

stock market line

**Chapter 6**

* 1. Which term has a different meaning than the others?

Diversifiable risk

Firm-specific risk

**Market risk**

Nonsystematic risk

Unsystematic risk

* 1. Systematic risk is also called \_\_\_\_\_.

Check all that apply:

**common risk**

fundamental risk

**market risk**

**non-diversifiable risk**

* 1. Nonsystematic risk is also called \_\_\_\_\_.

Check all that apply:

random risk

**firm-specific risk**

**diversifiable risk**

**unsystematic risk**

* 1. As different securities are added to a portfolio, the portfolio's total risk \_\_\_\_\_.

increases

is unaffected

**decreases**

falls to zero

NOTES: The benefit of diversification is that total risk falls as more and more different securities are added to a portfolio, up to the point where all unsystematic risk is eliminated and only systematic risk remains.

* 1. Factors that create systematic risk include \_\_\_\_\_.

Check all that apply:

earnings surprises

**inflation**

**interest** **rates**

**the business cycle**

**wars**

* 1. According to the mean-variance criterion, portfolio A is better than portfolio B for a risk-averse investor whenever \_\_\_\_\_.

E(rA) ≤ E(rB) and σA ≤ σB

E(rA) ≤ E(rB) and σA ≥ σB

**E(rA) ≥ E(rB) and σA ≤ σB**

E(rA) ≥ E(rB) and σA ≥ σB

* 1. The optimal risky portfolio is \_\_\_\_\_.

above the efficient frontier

below the efficient frontier

**found at the point of tangency between the line through the risk-free asset and the efficient frontier**

the portfolio with the greatest expected return

the portfolio with the smallest variance

* 1. The efficient frontier is the subset of feasible portfolios that \_\_\_\_\_.

Check all that apply:

minimizes the standard deviation

maximizes the expected return

**offers the maximum return for a given standard deviation**

**offers the minimum standard deviation for a given return**

* 1. When constructing a risky portfolio consisting only of risky assets, an investment manager should offer \_\_\_\_\_.

a customized risky portfolio to each client based on their ability to cope with losses

a customized risky portfolio to each client based on their required return

a customized risky portfolio to each client based on their risk aversion

**the same risky portfolio to all clients**

* 1. The main reason to use an index model instead of the full covariance matrix is that \_\_\_\_\_.

the index model is more accurate

the index model is more flexible

the full covariance matrix cannot handle correlated returns

**the full covariance matrix requires too many estimates for the inputs**

* 1. Let ri be the return for security i, Ri the excess return, and rM and RM the same for the market index. Which regression equation is often used in practice to estimate βi?

ri(t) = βi rM(t) + ei(t)M

ri(t) = αi + βi rM(t) + ei(t)

Ri(t) = βi RM(t) + ei(t)

Ri(t) = αi + βi RM(t) + ei(t)

1. Consider the following two stocks:

| Security | Standard deviation of returns | Beta |
| --- | --- | --- |
| Stock 1 | 12% | 1.8 |
| Stock 2 | 25% | 1.1 |

* 1. Which stock has more total risk?

Stock 1

**Stock 2**

NOTES: Stock 2 has more total risk, since its standard deviation is greater.

* 1. Which stock has more systematic risk?

**Stock 1**

Stock 2

NOTES: Stock 1 has more systematic risk, since its beta is greater.

* 1. Which stock should have the higher expected return?

**Stock 1**

Stock 2

NOTES: Stock 1 should have the higher expected return, since its beta is greater. According to the systematic risk principle, only systematic risk matters for the reward (return) for bearing risk.

* 1. Beta measures the \_\_\_\_\_.

unsystematic or specific risk of a stock

risk-reward trade-off for a stock

**systematic or market risk of a stock**

volatility of returns for a stock

* 1. The beta of the market portfolio is \_\_\_\_\_.

**1**

0

>0 and less than 1

>1

NOTES: The beta of the market portfolio is 1. Beta is the slope of the regression line. The slope is necessarily 1 if we regress the (excess) return onf the market portfolio on the (excess) return of the market portfolio.

* 1. Treasury bills are assumed to have a beta of \_\_\_\_\_.

1

**0 -** Treasury bills are commonly assumed to be risk-free, implying a beta of zero.

rf

E(rM)-rf

**Chapter 7**

* 1. Which of the following represent assumptions of the CAPM?

Check all that apply:

**All investors have the same holding period.**

Investments are limited to stocks and bonds.

**All investors trade without taxes or transaction costs.**

**All investors have homogeneous expectations about expected returns, variances and covariances.**

* 1. According to the CAPM, the optimal risky portfolio \_\_\_\_\_.

**contains all assets in the economy**

depends on risk aversion

has the lowest systematic risk

has the highest expected return

* 1. Which statements are true according to the CAPM?

Check all that apply:

**There is reward for bearing risk.**

**The higher the risk, the higher the expected reward.**

**Only systematic risk matters for the expected reward.**

Total risk matters for the expected reward.

* 1. According to the CAPM, the risk premium on any asset is a function of the asset's \_\_\_\_\_.

alpha and beta

**beta**

standard deviation

total risk

* 1. Stock A's beta is 1.1 and Stock B's beta is 0.5. If the CAPM holds, which of the following statements is correct?

Held as an individual security, stock A is riskier than B.

Stock B is a better addition to a portfolio than A.

**The expected return on stock A is greater than that on B.**

The expected return on stock B is greater than that on A.

* 1. The graphical representation of the CAPM is called the \_\_\_\_\_.

CAPM line

**security market line**

security characteristic line

yield curve

* 1. According to the CAPM, individual assets plot \_\_\_\_\_ the SML, and well-diversified portfolios plot \_\_\_\_\_ the SML.

**on; on**

on; on or around

on or around; on

on or around; on or around

* 1. The slope of the security market line equals the \_\_\_\_\_.

asset's beta

return on the asset

market return

**market risk premium**

* 1. The difference between the stock's fair expected return and its actual expected return is called the stock's \_\_\_\_\_.

beta

**alpha**

risk premium

reward-to-risk

* 1. Which of the following statements is true about a stock's alpha?

Check all that apply:

It represents the difference between a stock's fair expected return and the risk premium on the market portfolio.

Fairly priced stocks have positive alphas.

**Fairly priced stocks have zero alphas.**

Overpriced stocks have positive alphas.

**It represents the difference between a stock's fair expected return and its actual expected return.**

* 1. The theory stating that investors can obtain an efficient portfolio by investing in a market-index portfolio is called the \_\_\_\_\_.

**mutual fund theorem**

passive theorem

efficiency theorem

market-neutral theorem

modern portfolio theorem

* 1. Which of the following variables are used to explain stock returns in the Fama-French three-factor model?

Check all that apply:

**Return on the market index**

**Company size (market capitalization)**

**Company price-to-book ratio**

Industry size

Interest rate

* 1. What does the APT say about alpha?

Alpha equals the risk-free rate.

Alpha is irrelevant.

Alpha is zero for all securities.

**Alpha is zero for well-diversified portfolios.**

* 1. **Which of the following statements are true about the CAPM and the APT?**

**Check all that apply: IDK THIS ONE**

The APT applies only to well-diversified portfolios.

The APT guarantees that in the absence of arbitrage opportunities, the expected return-beta relationship will hold for all assets.

The CAPM applies to all securities.

The expected return-beta relationship is the same for both theories.

* 1. Stocks with a beta of zero offer an expected return of zero.

Check all that apply:

True

**False**

* 1. The CAPM implies that investors require a higher return to hold highly volatile securities.

Check all that apply:

True

**False**

* 1. You can construct a portfolio with a beta of 0.75 by investing 75% of the portfolio in the market portfolio and the remainder in T-bills.

Check all that apply:

**True**

False