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Module 2 Honors Quiz

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1. A limited liability corporation in which you are a shareholder has just gone bankrupt. The company has a large debt, that is its liabilities are far in excess of its assets. Hence, you will be called on to pay:

1 / 1 point

- ☐ An amount that could, at most, equal what you originally paid for the shares of common stock in the corporation.
- ☐ A proportional share of all creditor claims based on the number of common shares that you own.
- ☒ Nothing.
- ☐ A proportion of the total debt, which is decided at the discretion of the bankruptcy judge.

✓ Correct

You are a limited liability investor, hence you are not liable for the debt of the firm. You will at most lose the value of your shares.

2. The inflation risk, which inflation indexation aims to mitigate (check all that apply)

1 / 1 point

- ☒ Is not the risk that there will be inflation, it is the risk that inflation will significantly fluctuate over time.

✓ Correct

- ☒ Is the risk that the cash flow from an investment won't be worth as much in the future because of changes in purchasing power due to inflation.

✓ Correct

- ☐ Is the risk that the nominal rate of return of an investment will exceed the rate of inflation.

- ☒ Is associated with any investment that involves cash flows over time.

✓ Correct

3. The concept of human capital risk (check all that apply):

1 / 1 point

- ☒ Is a risk associated with the present value of all your future wages.

✓ Correct

- ☐ Is not correlated with professional competency.

- ☐ Is not correlated with the stock market.

- ☒ Can also be considered as a protection against inflation.

✓ Correct

4. The random walk hypothesis of the Efficient Market Theory posits that:

1 / 1 point

- ☐ Historical stock prices follow a random walk.
- ☐ Stock price volatility follows a random walk.
- ☐ Historical stock returns follow a random walk.
- ☒ Short-term investment returns are inherently unpredictable.

✓ Correct

5. Suppose a market is inefficient. As new information is received about an asset:

1 / 1 point

- ☐ The volatility (standard deviation) of the stock price will increase.
- ☐ Nothing will happen.
- ☐ Investors will short the stock.
- ☒ There will be a lag in the adjustment of the stock price.

✓ Correct

In an efficient market, the stock price will be instantaneously updated after new information is received.

6. Investors mainly use the price-to-earnings (P/E) ratio in order to:

1 / 1 point

- ☒ Decide whether a company's shares are overpriced or underpriced.
- ☐ Determine the optimal risk-return ratio.
- ☐ Decide how much profit a company is likely to make in the future.
- ☐ Determine the optimal price for the company's products.

✓ Correct

For instance, a high P/E ratio can imply that the shares are overpriced with respect to the company's fundamental value.

7. What is the shape of the value function in prospect theory?

1 / 1 point

- ☐ Gains: concave up; Losses: concave up
- ☐ Gains: concave up, Losses: concave down
- ☒ Gains: concave down; Losses: concave up
- ☐ Gains: concave down; Losses: concave down

✓ Correct

Since gains are concave up, gaining \$2000 on one day has a lower value than gaining \$1000 on two separate days. Since losses are concave down, losing \$20000 on one day has a higher value than losing \$1000 on two separate days.

8. Which of the following provide evidence that investors experience cognitive dissonance?

1 / 1 point

- ☐ Investors buy and sell stocks very rapidly
- ☐ Investors choose investments which already have many other investors
- ☒ Investors do not remember the negative performance of their investments.

✓ Correct

They selectively remember when their investments were doing well. Thus, they still feel they made a good decision.

- ☒ Investors hold onto funds that are doing poorly

✓ Correct

If they initially chose to invest in the fund, they selectively ignore evidence that their choice was wrong.

9. Which of the following situations are examples of the framing effect? (check all that apply)

1 / 1 point

- ☐ An elevator lists a maximum capacity of 2000 lbs, even though it can safely carry up to 5000 lbs.
- ☒ A mattress which costs \$1000 is advertised as \$4000 with a "75% off" sticker on it

✓ Correct

Rather than buying a \$1000 mattress, the customer believes she is getting a \$4000 mattress for the price of a \$1000 mattress.

- ☐ A gold coin is sold for \$1000, even though it is only worth \$300.
- ☒ A stock splits from \$60 to \$30 and investors are given twice as many shares

✓ Correct

When it splits, investors still remember the \$60 price and thus are willing to pay more for a share.

10. Which of the following defines the relationship of doctors to patients, but generally does not apply to the relationship of financial advisors to their clients?

1 / 1 point

- ☐ Patients can do their own background research on medical concepts to help them better understand their health, but finance is too complicated for clients to do this.
- ☐ Doctors use both data and experience/intuition when advising patients, but financial advisors must use either one or the other.
- ☒ Doctors have made an oath of loyalty to their patients, but financial advisors have not.

- ☐ Patients may seek second opinions from other doctors, but not from financial advisors.

✓ Correct

11. Which describes the concept of social contagion?

1 / 1 point

- ☒ Mathematical models of disease spread can be applied to the spread of ideas
- ☐ Ideas can evolve and develop in a similar way to genes, and we can use the principles of evolutionary biology to understand this development.
- ☐ Contagious diseases tend to spread in social situations.
- ☐ When an idea gains cultural momentum, it is more likely to be propagated throughout generations

✓ Correct