Chapter 01

Investments: Background and Issues

**Multiple Choice Questions**

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| 1. | Financial assets represent \_\_\_\_\_ of total assets of U.S. households.      |  |  | | --- | --- | | A. | over 60% |  |  |  | | --- | --- | | B. | over 90% |  |  |  | | --- | --- | | C. | under 10% |  |  |  | | --- | --- | | D. | about 30% | |

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| 2. | Real assets in the economy include all but which one of the following?      |  |  | | --- | --- | | A. | Land |  |  |  | | --- | --- | | B. | Buildings |  |  |  | | --- | --- | | C. | Consumer durables |  |  |  | | --- | --- | | D. | Common stock | |

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| 3. | Net worth represents \_\_\_\_\_ of the liabilities and net worth of commercial banks.      |  |  | | --- | --- | | A. | about 51% |  |  |  | | --- | --- | | B. | about 91% |  |  |  | | --- | --- | | C. | about 11% |  |  |  | | --- | --- | | D. | about 31% | |

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| 4. | According to the *Flow of Funds Accounts of the United States,* the largest single asset of U.S. households is \_\_\_.      |  |  | | --- | --- | | A. | mutual fund shares |  |  |  | | --- | --- | | B. | real estate |  |  |  | | --- | --- | | C. | pension reserves |  |  |  | | --- | --- | | D. | corporate equity | |

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| 5. | According to the *Flow of Funds Accounts of the United States,* the largest liability of U.S. households is \_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | mortgages |  |  |  | | --- | --- | | B. | consumer credit |  |  |  | | --- | --- | | C. | bank loans |  |  |  | | --- | --- | | D. | gambling debts | |

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| 6. | \_\_\_\_ is *not* a derivative security.      |  |  | | --- | --- | | A. | A share of common stock |  |  |  | | --- | --- | | B. | A call option |  |  |  | | --- | --- | | C. | A futures contract |  |  |  | | --- | --- | | D. | None of these options (All of the answers are derivative securities.) | |

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| 7. | According to the *Flow of Funds Accounts of the United States,* the largest financial asset of U.S. households is \_\_\_\_.      |  |  | | --- | --- | | A. | mutual fund shares |  |  |  | | --- | --- | | B. | corporate equity |  |  |  | | --- | --- | | C. | pension reserves |  |  |  | | --- | --- | | D. | personal trusts | |

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| 8. | Active trading in markets and competition among securities analysts helps ensure that:  I. Security prices approach informational efficiency II. Riskier securities are priced to offer higher potential returns III. Investors are unlikely to be able to consistently find under- or overvalued securities      |  |  | | --- | --- | | A. | I only |  |  |  | | --- | --- | | B. | I and II only |  |  |  | | --- | --- | | C. | II and III only |  |  |  | | --- | --- | | D. | I, II, and III | |

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| 9. | The material wealth of society is determined by the economy's \_\_\_\_\_\_\_\_\_, which is a function of the economy's \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | investment bankers; financial assets |  |  |  | | --- | --- | | B. | investment bankers; real assets |  |  |  | | --- | --- | | C. | productive capacity; financial assets |  |  |  | | --- | --- | | D. | productive capacity; real assets | |

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| 10. | Which of the following is *not* a money market security?      |  |  | | --- | --- | | A. | U.S. Treasury bill |  |  |  | | --- | --- | | B. | 6-month maturity certificate of deposit |  |  |  | | --- | --- | | C. | Common stock |  |  |  | | --- | --- | | D. | Bankers' acceptance | |

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| 11. | \_\_\_\_\_\_\_\_\_\_ assets generate net income to the economy, and \_\_\_\_\_\_\_\_\_\_ assets define allocation of income among investors.      |  |  | | --- | --- | | A. | Financial, financial |  |  |  | | --- | --- | | B. | Financial, real |  |  |  | | --- | --- | | C. | Real, financial |  |  |  | | --- | --- | | D. | Real, real | |

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| 12. | Which of the following are financial assets?  I. Debt securities II. Equity securities III. Derivative securities      |  |  | | --- | --- | | A. | I only |  |  |  | | --- | --- | | B. | I and II only |  |  |  | | --- | --- | | C. | II and III only |  |  |  | | --- | --- | | D. | I, II, and III | |

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| 13. | \_\_\_\_\_\_\_\_\_\_ are examples of financial intermediaries.      |  |  | | --- | --- | | A. | Commercial banks |  |  |  | | --- | --- | | B. | Insurance companies |  |  |  | | --- | --- | | C. | Investment companies |  |  |  | | --- | --- | | D. | All of these options | |

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| 14. | *Asset allocation* refers to \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | the allocation of the investment portfolio across broad asset classes |  |  |  | | --- | --- | | B. | the analysis of the value of securities |  |  |  | | --- | --- | | C. | the choice of specific assets within each asset class |  |  |  | | --- | --- | | D. | none of these options | |

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| 15. | Which one of the following best describes the purpose of derivatives markets?      |  |  | | --- | --- | | A. | Transferring risk from one party to another |  |  |  | | --- | --- | | B. | Investing for a short time period to earn a small rate of return |  |  |  | | --- | --- | | C. | Investing for retirement |  |  |  | | --- | --- | | D. | Earning interest income | |

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| 16. | More than \_\_\_\_\_\_\_\_\_\_\_\_\_ of currency is traded each day in the market for foreign exchange.      |  |  | | --- | --- | | A. | $300 million |  |  |  | | --- | --- | | B. | $1 billion |  |  |  | | --- | --- | | C. | $30 billion |  |  |  | | --- | --- | | D. | $1 trillion | |

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| 17. | *Security selection* refers to the \_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | allocation of the investment portfolio across broad asset classes |  |  |  | | --- | --- | | B. | analysis of the value of securities |  |  |  | | --- | --- | | C. | choice of specific securities within each asset class |  |  |  | | --- | --- | | D. | top-down method of investing | |

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| 18. | Which of the following is an example of an agency problem?      |  |  | | --- | --- | | A. | Managers engage in empire building. |  |  |  | | --- | --- | | B. | Managers protect their jobs by avoiding risky projects. |  |  |  | | --- | --- | | C. | Managers over consume luxuries such as corporate jets. |  |  |  | | --- | --- | | D. | All of these options are examples of agency problems. | |

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| 19. | \_\_\_\_\_ is a mechanism for mitigating potential agency problems.      |  |  | | --- | --- | | A. | Tying income of managers to success of the firm |  |  |  | | --- | --- | | B. | Directors defending top management |  |  |  | | --- | --- | | C. | Antitakeover strategies |  |  |  | | --- | --- | | D. | The straight voting method of electing the board of directors | |

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| 20. | \_\_\_\_\_\_\_\_\_\_ is (are) real assets.      |  |  | | --- | --- | | A. | Bonds |  |  |  | | --- | --- | | B. | Production equipment |  |  |  | | --- | --- | | C. | Stocks |  |  |  | | --- | --- | | D. | Commercial paper | |

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| 21. | \_\_\_\_\_\_\_\_\_\_ portfolio construction starts with selecting attractively priced securities.      |  |  | | --- | --- | | A. | Bottom-up |  |  |  | | --- | --- | | B. | Top-down |  |  |  | | --- | --- | | C. | Upside-down |  |  |  | | --- | --- | | D. | Side-to-side | |

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| 22. | In a market economy, capital resources are primarily allocated by \_\_\_\_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | governments |  |  |  | | --- | --- | | B. | the SEC |  |  |  | | --- | --- | | C. | financial markets |  |  |  | | --- | --- | | D. | investment bankers | |

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| 23. | \_\_\_\_\_\_\_\_\_\_ represents an ownership share in a corporation.      |  |  | | --- | --- | | A. | A call option |  |  |  | | --- | --- | | B. | Common stock |  |  |  | | --- | --- | | C. | A fixed-income security |  |  |  | | --- | --- | | D. | Preferred stock | |

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| 24. | The value of a derivative security \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | depends on the value of another related security |  |  |  | | --- | --- | | B. | affects the value of a related security |  |  |  | | --- | --- | | C. | is unrelated to the value of a related security |  |  |  | | --- | --- | | D. | can be integrated only by calculus professors | |

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| 25. | Commodity and derivative markets allow firms to adjust their \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | management styles |  |  |  | | --- | --- | | B. | focus from their main line of business to their investment portfolios |  |  |  | | --- | --- | | C. | ways of doing business so that they'll always have positive returns |  |  |  | | --- | --- | | D. | exposure to various business risks | |

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| 26. | \_\_\_\_\_\_\_\_\_\_ portfolio management calls for holding diversified portfolios without spending effort or resources attempting to improve investment performance through security analysis.      |  |  | | --- | --- | | A. | Active |  |  |  | | --- | --- | | B. | Momentum |  |  |  | | --- | --- | | C. | Passive |  |  |  | | --- | --- | | D. | Market-timing | |

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| 27. | Financial markets allow for all but which one of the following?      |  |  | | --- | --- | | A. | Shift consumption through time from higher-income periods to lower |  |  |  | | --- | --- | | B. | Price securities according to their riskiness |  |  |  | | --- | --- | | C. | Channel funds from lenders of funds to borrowers of funds |  |  |  | | --- | --- | | D. | Allow most participants to routinely earn high returns with low risk | |

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| 28. | Financial intermediaries exist because small investors cannot efficiently \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | diversify their portfolios |  |  |  | | --- | --- | | B. | gather information |  |  |  | | --- | --- | | C. | monitor their portfolios |  |  |  | | --- | --- | | D. | all of these options | |

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| 29. | Methods of encouraging managers to act in shareholders' best interest include:  I. Threat of takeover II. Proxy fights for control of the board of directors III. Tying managers' compensation to stock price performance      |  |  | | --- | --- | | A. | I only |  |  |  | | --- | --- | | B. | I and II only |  |  |  | | --- | --- | | C. | II and III only |  |  |  | | --- | --- | | D. | I, II, and III | |

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| 30. | Firms that specialize in helping companies raise capital by selling securities to the public are called \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | pension funds |  |  |  | | --- | --- | | B. | investment banks |  |  |  | | --- | --- | | C. | savings banks |  |  |  | | --- | --- | | D. | REITs | |

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| 31. | In securities markets, there should be a risk-return trade-off with higher-risk assets having \_\_\_\_\_\_\_\_\_ expected returns than lower-risk assets.      |  |  | | --- | --- | | A. | higher |  |  |  | | --- | --- | | B. | lower |  |  |  | | --- | --- | | C. | the same |  |  |  | | --- | --- | | D. | The answer cannot be determined from the information given. | |

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| 32. | When the market is more optimistic about a firm, its share price will \_\_\_\_\_\_; as a result, it will need to issue \_\_\_\_\_\_\_ shares to raise funds that are needed.      |  |  | | --- | --- | | A. | rise; fewer |  |  |  | | --- | --- | | B. | fall; fewer |  |  |  | | --- | --- | | C. | rise; more |  |  |  | | --- | --- | | D. | fall; more | |

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| 33. | *Security selection* refers to \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | choosing specific securities within each asset class |  |  |  | | --- | --- | | B. | deciding how much to invest in each asset class |  |  |  | | --- | --- | | C. | deciding how much to invest in the market portfolio versus the riskless asset |  |  |  | | --- | --- | | D. | deciding how much to hedge | |

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| 34. | An example of a derivative security is \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | a common share of General Motors |  |  |  | | --- | --- | | B. | a call option on Intel stock |  |  |  | | --- | --- | | C. | a Ford bond |  |  |  | | --- | --- | | D. | a U.S. Treasury bond | |

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| 35. | \_\_\_\_\_\_\_\_\_\_ portfolio construction starts with asset allocation.      |  |  | | --- | --- | | A. | Bottom-up |  |  |  | | --- | --- | | B. | Top-down |  |  |  | | --- | --- | | C. | Upside-down |  |  |  | | --- | --- | | D. | Side-to-side | |

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| 36. | Which one of the following firms falsely claimed to have a $4.8 billion bank account at Bank of America and vastly understated its debts, eventually resulting in the firm's bankruptcy?      |  |  | | --- | --- | | A. | WorldCom |  |  |  | | --- | --- | | B. | Enron |  |  |  | | --- | --- | | C. | Parmalat |  |  |  | | --- | --- | | D. | Global Crossing | |

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| 37. | Debt securities promise:  I. A fixed stream of income II. A stream of income that is determined according to a specific formula III. A share in the profits of the issuing entity      |  |  | | --- | --- | | A. | I only |  |  |  | | --- | --- | | B. | I or II only |  |  |  | | --- | --- | | C. | I and III only |  |  |  | | --- | --- | | D. | II or III only | |

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| 38. | The Sarbanes-Oxley Act tightened corporate governance rules by requiring all but which one of the following?      |  |  | | --- | --- | | A. | Required that corporations have more independent directors |  |  |  | | --- | --- | | B. | Required that the CFO personally vouch for the corporation's financial statements |  |  |  | | --- | --- | | C. | Required that firms could no longer employ investment bankers to sell securities to the public |  |  |  | | --- | --- | | D. | Required the creation of a new board to oversee the auditing of public companies | |

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| 39. | The success of common stock investments depends on the success of \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | derivative securities |  |  |  | | --- | --- | | B. | fixed-income securities |  |  |  | | --- | --- | | C. | the firm and its real assets |  |  |  | | --- | --- | | D. | government methods of allocating capital | |

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| 40. | The historical average rate of return on large company stocks since 1926 has been \_\_\_\_\_.      |  |  | | --- | --- | | A. | 5% |  |  |  | | --- | --- | | B. | 8% |  |  |  | | --- | --- | | C. | 12% |  |  |  | | --- | --- | | D. | 20% | |

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| 41. | The average rate of return on U.S. Treasury bills since 1926 was \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | less than 1% |  |  |  | | --- | --- | | B. | less than 3% |  |  |  | | --- | --- | | C. | less than 4% |  |  |  | | --- | --- | | D. | less than 7% | |

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| 42. | An example of a real asset is:  I. A college education II. Customer goodwill III. A patent      |  |  | | --- | --- | | A. | I only |  |  |  | | --- | --- | | B. | II only |  |  |  | | --- | --- | | C. | I and III only |  |  |  | | --- | --- | | D. | I, II, and III | |

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| 43. | The 2002 law designed to improve corporate governance is titled the \_\_\_\_\_.      |  |  | | --- | --- | | A. | Pension Reform Act |  |  |  | | --- | --- | | B. | ERISA |  |  |  | | --- | --- | | C. | Financial Services Modernization Act |  |  |  | | --- | --- | | D. | Sarbanes-Oxley Act | |

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| 44. | Which of the following is *not* a financial intermediary?      |  |  | | --- | --- | | A. | a mutual fund |  |  |  | | --- | --- | | B. | an insurance company |  |  |  | | --- | --- | | C. | a real estate brokerage firm |  |  |  | | --- | --- | | D. | a savings and loan company | |

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| 45. | The combined liabilities of American households represent approximately \_\_\_\_\_\_\_\_\_\_ of combined assets.      |  |  | | --- | --- | | A. | 11% |  |  |  | | --- | --- | | B. | 19% |  |  |  | | --- | --- | | C. | 25% |  |  |  | | --- | --- | | D. | 33% | |

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| 46. | In 2011 real assets represented approximately \_\_\_\_\_\_\_\_\_\_ of the total asset holdings of American households.      |  |  | | --- | --- | | A. | 32% |  |  |  | | --- | --- | | B. | 42% |  |  |  | | --- | --- | | C. | 48% |  |  |  | | --- | --- | | D. | 55% | |

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| 47. | In 2011 mortgages represented approximately \_\_\_\_\_\_\_\_\_\_ of total liabilities and net worth of American households.      |  |  | | --- | --- | | A. | 12% |  |  |  | | --- | --- | | B. | 14% |  |  |  | | --- | --- | | C. | 28% |  |  |  | | --- | --- | | D. | 42% | |

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| 48. | Liabilities equal approximately \_\_\_\_\_ of total assets for nonfinancial U.S. businesses.      |  |  | | --- | --- | | A. | 10% |  |  |  | | --- | --- | | B. | 25% |  |  |  | | --- | --- | | C. | 48% |  |  |  | | --- | --- | | D. | 75% | |

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| 49. | Which of the following is *not* an example of a financial intermediary?      |  |  | | --- | --- | | A. | Goldman Sachs |  |  |  | | --- | --- | | B. | Allstate Insurance |  |  |  | | --- | --- | | C. | First Interstate Bank |  |  |  | | --- | --- | | D. | IBM | |

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| 50. | Real assets represent about \_\_\_\_ of total assets for commercial banks.      |  |  | | --- | --- | | A. | 1% |  |  |  | | --- | --- | | B. | 15% |  |  |  | | --- | --- | | C. | 25% |  |  |  | | --- | --- | | D. | 40% | |

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| 51. | Money market securities are characterized by:  I. Maturity less than 1 year II. Safety of the principal investment III. Low rates of return      |  |  | | --- | --- | | A. | I only |  |  |  | | --- | --- | | B. | I and II only |  |  |  | | --- | --- | | C. | I and III only |  |  |  | | --- | --- | | D. | I, II, and III | |

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| 52. | After much investigation, an investor finds that Intel stock is currently underpriced. This is an example of \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | asset allocation |  |  |  | | --- | --- | | B. | security analysis |  |  |  | | --- | --- | | C. | top-down portfolio management |  |  |  | | --- | --- | | D. | passive management | |

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| 53. | After considering current market conditions, an investor decides to place 60% of her funds in equities and the rest in bonds. This is an example of \_\_\_\_\_.      |  |  | | --- | --- | | A. | asset allocation |  |  |  | | --- | --- | | B. | security analysis |  |  |  | | --- | --- | | C. | top-down portfolio management |  |  |  | | --- | --- | | D. | passive management | |

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| 54. | Suppose an investor is considering one of two investments that are identical in all respects except for risk. If the investor anticipates a fair return for the risk of the security he invests in, he can expect to \_\_\_\_\_.      |  |  | | --- | --- | | A. | earn no more than the Treasury-bill rate on either security. |  |  |  | | --- | --- | | B. | pay less for the security that has higher risk. |  |  |  | | --- | --- | | C. | pay less for the security that has lower risk. |  |  |  | | --- | --- | | D. | earn more if interest rates are lower. | |

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| 55. | The efficient market hypothesis suggests that \_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | active portfolio management strategies are the most appropriate investment strategies |  |  |  | | --- | --- | | B. | passive portfolio management strategies are the most appropriate investment strategies |  |  |  | | --- | --- | | C. | either active or passive strategies may be appropriate, depending on the expected direction of the market |  |  |  | | --- | --- | | D. | a bottom-up approach is the most appropriate investment strategy | |

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| 56. | In a perfectly efficient market the best investment strategy is probably \_\_\_\_\_.      |  |  | | --- | --- | | A. | an active strategy. |  |  |  | | --- | --- | | B. | a passive strategy. |  |  |  | | --- | --- | | C. | asset allocation. |  |  |  | | --- | --- | | D. | market timing. | |

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| 57. | Market signals will help to allocate capital efficiently only if investors are acting \_\_\_\_\_.      |  |  | | --- | --- | | A. | on the basis of their individual hunches. |  |  |  | | --- | --- | | B. | as directed by financial experts. |  |  |  | | --- | --- | | C. | as dominant forces in the economy. |  |  |  | | --- | --- | | D. | on accurate information. | |

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| 58. | Which of the following is (are) true about hedge funds?  I. They are open to institutional investors. II. They are open to wealthy individuals. III. They are more likely than mutual funds to pursue simple strategies.      |  |  | | --- | --- | | A. | I and II only |  |  |  | | --- | --- | | B. | I and III only |  |  |  | | --- | --- | | C. | II and III only |  |  |  | | --- | --- | | D. | I, II, and III | |

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| 59. | Venture capital is \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | frequently used to expand the businesses of well-established companies |  |  |  | | --- | --- | | B. | supplied by venture capital funds and individuals to start-up companies |  |  |  | | --- | --- | | C. | illegal under current U.S. laws |  |  |  | | --- | --- | | D. | most frequently issued with the help of investment bankers | |

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| 60. | Individuals may find it more advantageous to purchase claims from a financial intermediary rather than directly purchasing claims in capital markets because:  I. Intermediaries are better diversified than most individuals II. Intermediaries can exploit economies of scale in investing that individual investors cannot III. Intermediated investments usually offer higher rates of return than direct capital market claims      |  |  | | --- | --- | | A. | I only |  |  |  | | --- | --- | | B. | I and II only |  |  |  | | --- | --- | | C. | II and III only |  |  |  | | --- | --- | | D. | I, II, and III | |

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| 61. | Surf City Software Company develops new surf forecasting software. It sells the software to Microsoft in exchange for 1,000 shares of Microsoft common stock. Surf City Software has exchanged a \_\_\_\_\_ asset for a \_\_\_\_\_ asset in this transaction.      |  |  | | --- | --- | | A. | real; real |  |  |  | | --- | --- | | B. | financial; financial |  |  |  | | --- | --- | | C. | real; financial |  |  |  | | --- | --- | | D. | financial; real | |

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| 62. | Stone Harbor Products takes out a bank loan. It receives $100,000 and signs a promissory note to pay back the loan over 5 years. In this transaction, \_\_\_\_\_.      |  |  | | --- | --- | | A. | a new financial asset was created |  |  |  | | --- | --- | | B. | a financial asset was traded for a real asset |  |  |  | | --- | --- | | C. | a financial asset was destroyed |  |  |  | | --- | --- | | D. | a real asset was created | |

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| 63. | Which of the following firms was *not* engaged in a major accounting scandal between 2000 and 2005?      |  |  | | --- | --- | | A. | General Electric |  |  |  | | --- | --- | | B. | Parmalat |  |  |  | | --- | --- | | C. | Enron |  |  |  | | --- | --- | | D. | WorldCom | |

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| 64. | Accounting scandals can often be attributed to a particular concept in the study of finance known as the \_\_\_\_\_.      |  |  | | --- | --- | | A. | agency problem |  |  |  | | --- | --- | | B. | risk-return trade-off |  |  |  | | --- | --- | | C. | allocation of risk |  |  |  | | --- | --- | | D. | securitization | |

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| 65. | An intermediary that pools and manages funds for many investors is called \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | an investment company |  |  |  | | --- | --- | | B. | a savings and loan |  |  |  | | --- | --- | | C. | an investment banker |  |  |  | | --- | --- | | D. | a commercial bank | |

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| 66. | Financial institutions that specialize in assisting corporations in primary market transactions are called \_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | mutual funds |  |  |  | | --- | --- | | B. | investment bankers |  |  |  | | --- | --- | | C. | pension funds |  |  |  | | --- | --- | | D. | globalization specialists | |

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| 67. | When a pass-through mortgage security is issued, what does the issuing agency expect to receive?      |  |  | | --- | --- | | A. | The amount of the original loan plus a servicing fee |  |  |  | | --- | --- | | B. | The principal and interest that are paid by the homeowner |  |  |  | | --- | --- | | C. | The principal and interest that are paid by the homeowner, minus a servicing fee |  |  |  | | --- | --- | | D. | The interest paid by the homeowner, plus a servicing fee | |

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| 68. | In 2008 the largest corporate bankruptcy in U.S. history involved the investment banking firm of \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | Goldman Sachs |  |  |  | | --- | --- | | B. | Lehman Brothers |  |  |  | | --- | --- | | C. | Morgan Stanley |  |  |  | | --- | --- | | D. | Merrill Lynch | |

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| 69. | The inability of shareholders to influence the decisions of managers, despite overwhelming shareholder support, is a breakdown in what process or mechanism?      |  |  | | --- | --- | | A. | Auditing |  |  |  | | --- | --- | | B. | Public finance |  |  |  | | --- | --- | | C. | Corporate governance |  |  |  | | --- | --- | | D. | Public reporting | |

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| 70. | Real assets are \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | assets used to produce goods and services |  |  |  | | --- | --- | | B. | always the same as financial assets |  |  |  | | --- | --- | | C. | always equal to liabilities |  |  |  | | --- | --- | | D. | claims on a company's income | |

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| 71. | A major cause of mortgage market meltdown in 2007 and 2008 was linked to \_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | private equity investments |  |  |  | | --- | --- | | B. | securitization |  |  |  | | --- | --- | | C. | negative analyst recommendations |  |  |  | | --- | --- | | D. | online trading | |

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| 72. | In recent years the greatest dollar amount of securitization occurred for which type of loan?      |  |  | | --- | --- | | A. | Home mortgages |  |  |  | | --- | --- | | B. | Credit card debt |  |  |  | | --- | --- | | C. | Automobile loans |  |  |  | | --- | --- | | D. | Equipment leasing | |

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| 73. | Which of the following is (are) true about nonconforming mortgage loans?      |  |  | | --- | --- | | A. | They are also known as *subprime loans.* |  |  |  | | --- | --- | | B. | They have higher default risk than conforming loans. |  |  |  | | --- | --- | | C. | They were able to be offered without due diligence. |  |  |  | | --- | --- | | D. | All of these options are true. | |

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| 74. | The systemic risk that led to the financial crisis of 2008 was increased by \_\_\_\_\_.      |  |  | | --- | --- | | A. | collateralized debt obligations |  |  |  | | --- | --- | | B. | subprime mortgages |  |  |  | | --- | --- | | C. | credit default swaps |  |  |  | | --- | --- | | D. | all of the options | |

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| 75. | An investment adviser has decided to purchase gold, real estate, stocks, and bonds in equal amounts. This decision reflects which part of the investment process?      |  |  | | --- | --- | | A. | Asset allocation |  |  |  | | --- | --- | | B. | Investment analysis |  |  |  | | --- | --- | | C. | Portfolio analysis |  |  |  | | --- | --- | | D. | Security selection | |

Chapter 01 Investments: Background and Issues Answer Key

**Multiple Choice Questions**

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| 1. | Financial assets represent \_\_\_\_\_ of total assets of U.S. households.      |  |  | | --- | --- | | **A.** | over 60% |  |  |  | | --- | --- | | B. | over 90% |  |  |  | | --- | --- | | C. | under 10% |  |  |  | | --- | --- | | D. | about 30% | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 2. | Real assets in the economy include all but which one of the following?      |  |  | | --- | --- | | A. | Land |  |  |  | | --- | --- | | B. | Buildings |  |  |  | | --- | --- | | C. | Consumer durables |  |  |  | | --- | --- | | **D.** | Common stock | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 3. | Net worth represents \_\_\_\_\_ of the liabilities and net worth of commercial banks.      |  |  | | --- | --- | | A. | about 51% |  |  |  | | --- | --- | | B. | about 91% |  |  |  | | --- | --- | | **C.** | about 11% |  |  |  | | --- | --- | | D. | about 31% | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Financial Intermediaries* |

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| 4. | According to the *Flow of Funds Accounts of the United States,* the largest single asset of U.S. households is \_\_\_.      |  |  | | --- | --- | | A. | mutual fund shares |  |  |  | | --- | --- | | **B.** | real estate |  |  |  | | --- | --- | | C. | pension reserves |  |  |  | | --- | --- | | D. | corporate equity | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 5. | According to the *Flow of Funds Accounts of the United States,* the largest liability of U.S. households is \_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | **A.** | mortgages |  |  |  | | --- | --- | | B. | consumer credit |  |  |  | | --- | --- | | C. | bank loans |  |  |  | | --- | --- | | D. | gambling debts | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 6. | \_\_\_\_ is *not* a derivative security.      |  |  | | --- | --- | | **A.** | A share of common stock |  |  |  | | --- | --- | | B. | A call option |  |  |  | | --- | --- | | C. | A futures contract |  |  |  | | --- | --- | | D. | None of these options (All of the answers are derivative securities.) | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Financial Assets* |

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| 7. | According to the *Flow of Funds Accounts of the United States,* the largest financial asset of U.S. households is \_\_\_\_.      |  |  | | --- | --- | | A. | mutual fund shares |  |  |  | | --- | --- | | B. | corporate equity |  |  |  | | --- | --- | | **C.** | pension reserves |  |  |  | | --- | --- | | D. | personal trusts | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 8. | Active trading in markets and competition among securities analysts helps ensure that:  I. Security prices approach informational efficiency II. Riskier securities are priced to offer higher potential returns III. Investors are unlikely to be able to consistently find under- or overvalued securities      |  |  | | --- | --- | | A. | I only |  |  |  | | --- | --- | | B. | I and II only |  |  |  | | --- | --- | | C. | II and III only |  |  |  | | --- | --- | | **D.** | I, II, and III | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 3 Hard Learning Objective: 01-03 Explain the economic functions of financial markets and how various securities are related to the governance of the corporation. Topic: Financial Markets and the Economy* |

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| 9. | The material wealth of society is determined by the economy's \_\_\_\_\_\_\_\_\_, which is a function of the economy's \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | investment bankers; financial assets |  |  |  | | --- | --- | | B. | investment bankers; real assets |  |  |  | | --- | --- | | C. | productive capacity; financial assets |  |  |  | | --- | --- | | **D.** | productive capacity; real assets | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 10. | Which of the following is *not* a money market security?      |  |  | | --- | --- | | A. | U.S. Treasury bill |  |  |  | | --- | --- | | B. | 6-month maturity certificate of deposit |  |  |  | | --- | --- | | **C.** | Common stock |  |  |  | | --- | --- | | D. | Bankers' acceptance | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Financial Assets* |

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| 11. | \_\_\_\_\_\_\_\_\_\_ assets generate net income to the economy, and \_\_\_\_\_\_\_\_\_\_ assets define allocation of income among investors.      |  |  | | --- | --- | | A. | Financial, financial |  |  |  | | --- | --- | | B. | Financial, real |  |  |  | | --- | --- | | **C.** | Real, financial |  |  |  | | --- | --- | | D. | Real, real | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 12. | Which of the following are financial assets?  I. Debt securities II. Equity securities III. Derivative securities      |  |  | | --- | --- | | A. | I only |  |  |  | | --- | --- | | B. | I and II only |  |  |  | | --- | --- | | C. | II and III only |  |  |  | | --- | --- | | **D.** | I, II, and III | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 3 Hard Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 13. | \_\_\_\_\_\_\_\_\_\_ are examples of financial intermediaries.      |  |  | | --- | --- | | A. | Commercial banks |  |  |  | | --- | --- | | B. | Insurance companies |  |  |  | | --- | --- | | C. | Investment companies |  |  |  | | --- | --- | | **D.** | All of these options | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-05 Identify different types of financial markets and the major participants in each of those markets. Topic: Financial Intermediaries* |

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| 14. | *Asset allocation* refers to \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | **A.** | the allocation of the investment portfolio across broad asset classes |  |  |  | | --- | --- | | B. | the analysis of the value of securities |  |  |  | | --- | --- | | C. | the choice of specific assets within each asset class |  |  |  | | --- | --- | | D. | none of these options | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-04 Describe the major steps in the construction of an investment portfolio. Topic: The Investment Process* |

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| 15. | Which one of the following best describes the purpose of derivatives markets?      |  |  | | --- | --- | | **A.** | Transferring risk from one party to another |  |  |  | | --- | --- | | B. | Investing for a short time period to earn a small rate of return |  |  |  | | --- | --- | | C. | Investing for retirement |  |  |  | | --- | --- | | D. | Earning interest income | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-03 Explain the economic functions of financial markets and how various securities are related to the governance of the corporation. Topic: Financial Markets and the Economy* |

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| 16. | More than \_\_\_\_\_\_\_\_\_\_\_\_\_ of currency is traded each day in the market for foreign exchange.      |  |  | | --- | --- | | A. | $300 million |  |  |  | | --- | --- | | B. | $1 billion |  |  |  | | --- | --- | | C. | $30 billion |  |  |  | | --- | --- | | **D.** | $1 trillion | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-03 Explain the economic functions of financial markets and how various securities are related to the governance of the corporation. Topic: Financial Markets and the Economy* |

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| 17. | *Security selection* refers to the \_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | allocation of the investment portfolio across broad asset classes |  |  |  | | --- | --- | | B. | analysis of the value of securities |  |  |  | | --- | --- | | **C.** | choice of specific securities within each asset class |  |  |  | | --- | --- | | D. | top-down method of investing | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-04 Describe the major steps in the construction of an investment portfolio. Topic: The Investment Process* |

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| 18. | Which of the following is an example of an agency problem?      |  |  | | --- | --- | | A. | Managers engage in empire building. |  |  |  | | --- | --- | | B. | Managers protect their jobs by avoiding risky projects. |  |  |  | | --- | --- | | C. | Managers over consume luxuries such as corporate jets. |  |  |  | | --- | --- | | **D.** | All of these options are examples of agency problems. | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-03 Explain the economic functions of financial markets and how various securities are related to the governance of the corporation. Topic: Financial Markets and the Economy* |

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| 19. | \_\_\_\_\_ is a mechanism for mitigating potential agency problems.      |  |  | | --- | --- | | **A.** | Tying income of managers to success of the firm |  |  |  | | --- | --- | | B. | Directors defending top management |  |  |  | | --- | --- | | C. | Antitakeover strategies |  |  |  | | --- | --- | | D. | The straight voting method of electing the board of directors | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 3 Hard Learning Objective: 01-03 Explain the economic functions of financial markets and how various securities are related to the governance of the corporation. Topic: Financial Markets and the Economy* |

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| 20. | \_\_\_\_\_\_\_\_\_\_ is (are) real assets.      |  |  | | --- | --- | | A. | Bonds |  |  |  | | --- | --- | | **B.** | Production equipment |  |  |  | | --- | --- | | C. | Stocks |  |  |  | | --- | --- | | D. | Commercial paper | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 21. | \_\_\_\_\_\_\_\_\_\_ portfolio construction starts with selecting attractively priced securities.      |  |  | | --- | --- | | **A.** | Bottom-up |  |  |  | | --- | --- | | B. | Top-down |  |  |  | | --- | --- | | C. | Upside-down |  |  |  | | --- | --- | | D. | Side-to-side | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-04 Describe the major steps in the construction of an investment portfolio. Topic: The Investment Process* |

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| 22. | In a market economy, capital resources are primarily allocated by \_\_\_\_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | governments |  |  |  | | --- | --- | | B. | the SEC |  |  |  | | --- | --- | | **C.** | financial markets |  |  |  | | --- | --- | | D. | investment bankers | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-03 Explain the economic functions of financial markets and how various securities are related to the governance of the corporation. Topic: Financial Markets and the Economy* |

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| 23. | \_\_\_\_\_\_\_\_\_\_ represents an ownership share in a corporation.      |  |  | | --- | --- | | A. | A call option |  |  |  | | --- | --- | | **B.** | Common stock |  |  |  | | --- | --- | | C. | A fixed-income security |  |  |  | | --- | --- | | D. | Preferred stock | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Financial Assets* |

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| 24. | The value of a derivative security \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | **A.** | depends on the value of another related security |  |  |  | | --- | --- | | B. | affects the value of a related security |  |  |  | | --- | --- | | C. | is unrelated to the value of a related security |  |  |  | | --- | --- | | D. | can be integrated only by calculus professors | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Financial Assets* |

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| 25. | Commodity and derivative markets allow firms to adjust their \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | management styles |  |  |  | | --- | --- | | B. | focus from their main line of business to their investment portfolios |  |  |  | | --- | --- | | C. | ways of doing business so that they'll always have positive returns |  |  |  | | --- | --- | | **D.** | exposure to various business risks | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-03 Explain the economic functions of financial markets and how various securities are related to the governance of the corporation. Topic: Financial Markets and the Economy* |

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| 26. | \_\_\_\_\_\_\_\_\_\_ portfolio management calls for holding diversified portfolios without spending effort or resources attempting to improve investment performance through security analysis.      |  |  | | --- | --- | | A. | Active |  |  |  | | --- | --- | | B. | Momentum |  |  |  | | --- | --- | | **C.** | Passive |  |  |  | | --- | --- | | D. | Market-timing | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-04 Describe the major steps in the construction of an investment portfolio. Topic: Efficient Markets* |

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| 27. | Financial markets allow for all but which one of the following?      |  |  | | --- | --- | | A. | Shift consumption through time from higher-income periods to lower |  |  |  | | --- | --- | | B. | Price securities according to their riskiness |  |  |  | | --- | --- | | C. | Channel funds from lenders of funds to borrowers of funds |  |  |  | | --- | --- | | **D.** | Allow most participants to routinely earn high returns with low risk | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-03 Explain the economic functions of financial markets and how various securities are related to the governance of the corporation. Topic: Financial Markets and the Economy* |

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| 28. | Financial intermediaries exist because small investors cannot efficiently \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | diversify their portfolios |  |  |  | | --- | --- | | B. | gather information |  |  |  | | --- | --- | | C. | monitor their portfolios |  |  |  | | --- | --- | | **D.** | all of these options | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-05 Identify different types of financial markets and the major participants in each of those markets. Topic: Financial Intermediaries* |

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| 29. | Methods of encouraging managers to act in shareholders' best interest include:  I. Threat of takeover II. Proxy fights for control of the board of directors III. Tying managers' compensation to stock price performance      |  |  | | --- | --- | | A. | I only |  |  |  | | --- | --- | | B. | I and II only |  |  |  | | --- | --- | | C. | II and III only |  |  |  | | --- | --- | | **D.** | I, II, and III | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-03 Explain the economic functions of financial markets and how various securities are related to the governance of the corporation. Topic: Financial Markets and the Economy* |

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| 30. | Firms that specialize in helping companies raise capital by selling securities to the public are called \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | pension funds |  |  |  | | --- | --- | | **B.** | investment banks |  |  |  | | --- | --- | | C. | savings banks |  |  |  | | --- | --- | | D. | REITs | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-05 Identify different types of financial markets and the major participants in each of those markets. Topic: Financial Intermediaries* |

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| 31. | In securities markets, there should be a risk-return trade-off with higher-risk assets having \_\_\_\_\_\_\_\_\_ expected returns than lower-risk assets.      |  |  | | --- | --- | | **A.** | higher |  |  |  | | --- | --- | | B. | lower |  |  |  | | --- | --- | | C. | the same |  |  |  | | --- | --- | | D. | The answer cannot be determined from the information given. | |

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| 32. | When the market is more optimistic about a firm, its share price will \_\_\_\_\_\_; as a result, it will need to issue \_\_\_\_\_\_\_ shares to raise funds that are needed.      |  |  | | --- | --- | | **A.** | rise; fewer |  |  |  | | --- | --- | | B. | fall; fewer |  |  |  | | --- | --- | | C. | rise; more |  |  |  | | --- | --- | | D. | fall; more | |

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| 33. | *Security selection* refers to \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | **A.** | choosing specific securities within each asset class |  |  |  | | --- | --- | | B. | deciding how much to invest in each asset class |  |  |  | | --- | --- | | C. | deciding how much to invest in the market portfolio versus the riskless asset |  |  |  | | --- | --- | | D. | deciding how much to hedge | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-04 Describe the major steps in the construction of an investment portfolio. Topic: The Investment Process* |

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| 34. | An example of a derivative security is \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | a common share of General Motors |  |  |  | | --- | --- | | **B.** | a call option on Intel stock |  |  |  | | --- | --- | | C. | a Ford bond |  |  |  | | --- | --- | | D. | a U.S. Treasury bond | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Financial Assets* |

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| 35. | \_\_\_\_\_\_\_\_\_\_ portfolio construction starts with asset allocation.      |  |  | | --- | --- | | A. | Bottom-up |  |  |  | | --- | --- | | **B.** | Top-down |  |  |  | | --- | --- | | C. | Upside-down |  |  |  | | --- | --- | | D. | Side-to-side | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-04 Describe the major steps in the construction of an investment portfolio. Topic: The Investment Process* |

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| 36. | Which one of the following firms falsely claimed to have a $4.8 billion bank account at Bank of America and vastly understated its debts, eventually resulting in the firm's bankruptcy?      |  |  | | --- | --- | | A. | WorldCom |  |  |  | | --- | --- | | B. | Enron |  |  |  | | --- | --- | | **C.** | Parmalat |  |  |  | | --- | --- | | D. | Global Crossing | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-03 Explain the economic functions of financial markets and how various securities are related to the governance of the corporation. Topic: Financial Markets and the Economy* |

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| 37. | Debt securities promise:  I. A fixed stream of income II. A stream of income that is determined according to a specific formula III. A share in the profits of the issuing entity      |  |  | | --- | --- | | A. | I only |  |  |  | | --- | --- | | **B.** | I or II only |  |  |  | | --- | --- | | C. | I and III only |  |  |  | | --- | --- | | D. | II or III only | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Financial Assets* |

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| 38. | The Sarbanes-Oxley Act tightened corporate governance rules by requiring all but which one of the following?      |  |  | | --- | --- | | A. | Required that corporations have more independent directors |  |  |  | | --- | --- | | B. | Required that the CFO personally vouch for the corporation's financial statements |  |  |  | | --- | --- | | **C.** | Required that firms could no longer employ investment bankers to sell securities to the public |  |  |  | | --- | --- | | D. | Required the creation of a new board to oversee the auditing of public companies | |

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| 39. | The success of common stock investments depends on the success of \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | derivative securities |  |  |  | | --- | --- | | B. | fixed-income securities |  |  |  | | --- | --- | | **C.** | the firm and its real assets |  |  |  | | --- | --- | | D. | government methods of allocating capital | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Financial Assets* |

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| 40. | The historical average rate of return on large company stocks since 1926 has been \_\_\_\_\_.      |  |  | | --- | --- | | A. | 5% |  |  |  | | --- | --- | | B. | 8% |  |  |  | | --- | --- | | **C.** | 12% |  |  |  | | --- | --- | | D. | 20% | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-04 Describe the major steps in the construction of an investment portfolio. Topic: The Investment Process* |

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| 41. | The average rate of return on U.S. Treasury bills since 1926 was \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | less than 1% |  |  |  | | --- | --- | | B. | less than 3% |  |  |  | | --- | --- | | **C.** | less than 4% |  |  |  | | --- | --- | | D. | less than 7% | |

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| 42. | An example of a real asset is:  I. A college education II. Customer goodwill III. A patent      |  |  | | --- | --- | | A. | I only |  |  |  | | --- | --- | | B. | II only |  |  |  | | --- | --- | | C. | I and III only |  |  |  | | --- | --- | | **D.** | I, II, and III | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 43. | The 2002 law designed to improve corporate governance is titled the \_\_\_\_\_.      |  |  | | --- | --- | | A. | Pension Reform Act |  |  |  | | --- | --- | | B. | ERISA |  |  |  | | --- | --- | | C. | Financial Services Modernization Act |  |  |  | | --- | --- | | **D.** | Sarbanes-Oxley Act | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-03 Explain the economic functions of financial markets and how various securities are related to the governance of the corporation. Topic: Financial Markets and the Economy* |

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| 44. | Which of the following is *not* a financial intermediary?      |  |  | | --- | --- | | A. | a mutual fund |  |  |  | | --- | --- | | B. | an insurance company |  |  |  | | --- | --- | | **C.** | a real estate brokerage firm |  |  |  | | --- | --- | | D. | a savings and loan company | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Financial Intermediaries* |

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| 45. | The combined liabilities of American households represent approximately \_\_\_\_\_\_\_\_\_\_ of combined assets.      |  |  | | --- | --- | | A. | 11% |  |  |  | | --- | --- | | **B.** | 19% |  |  |  | | --- | --- | | C. | 25% |  |  |  | | --- | --- | | D. | 33% | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 46. | In 2011 real assets represented approximately \_\_\_\_\_\_\_\_\_\_ of the total asset holdings of American households.      |  |  | | --- | --- | | **A.** | 32% |  |  |  | | --- | --- | | B. | 42% |  |  |  | | --- | --- | | C. | 48% |  |  |  | | --- | --- | | D. | 55% | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 47. | In 2011 mortgages represented approximately \_\_\_\_\_\_\_\_\_\_ of total liabilities and net worth of American households.      |  |  | | --- | --- | | A. | 12% |  |  |  | | --- | --- | | **B.** | 14% |  |  |  | | --- | --- | | C. | 28% |  |  |  | | --- | --- | | D. | 42% | |

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| 48. | Liabilities equal approximately \_\_\_\_\_ of total assets for nonfinancial U.S. businesses.      |  |  | | --- | --- | | A. | 10% |  |  |  | | --- | --- | | B. | 25% |  |  |  | | --- | --- | | **C.** | 48% |  |  |  | | --- | --- | | D. | 75% | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 49. | Which of the following is *not* an example of a financial intermediary?      |  |  | | --- | --- | | A. | Goldman Sachs |  |  |  | | --- | --- | | B. | Allstate Insurance |  |  |  | | --- | --- | | C. | First Interstate Bank |  |  |  | | --- | --- | | **D.** | IBM | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Financial Intermediaries* |

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| 50. | Real assets represent about \_\_\_\_ of total assets for commercial banks.      |  |  | | --- | --- | | **A.** | 1% |  |  |  | | --- | --- | | B. | 15% |  |  |  | | --- | --- | | C. | 25% |  |  |  | | --- | --- | | D. | 40% | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Financial Intermediaries* |

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| 51. | Money market securities are characterized by:  I. Maturity less than 1 year II. Safety of the principal investment III. Low rates of return      |  |  | | --- | --- | | A. | I only |  |  |  | | --- | --- | | B. | I and II only |  |  |  | | --- | --- | | C. | I and III only |  |  |  | | --- | --- | | **D.** | I, II, and III | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Financial Assets* |

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| 52. | After much investigation, an investor finds that Intel stock is currently underpriced. This is an example of \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | asset allocation |  |  |  | | --- | --- | | **B.** | security analysis |  |  |  | | --- | --- | | C. | top-down portfolio management |  |  |  | | --- | --- | | D. | passive management | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-04 Describe the major steps in the construction of an investment portfolio. Topic: The Investment Process* |

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| 53. | After considering current market conditions, an investor decides to place 60% of her funds in equities and the rest in bonds. This is an example of \_\_\_\_\_.      |  |  | | --- | --- | | **A.** | asset allocation |  |  |  | | --- | --- | | B. | security analysis |  |  |  | | --- | --- | | C. | top-down portfolio management |  |  |  | | --- | --- | | D. | passive management | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-04 Describe the major steps in the construction of an investment portfolio. Topic: The Investment Process* |

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| 54. | Suppose an investor is considering one of two investments that are identical in all respects except for risk. If the investor anticipates a fair return for the risk of the security he invests in, he can expect to \_\_\_\_\_.      |  |  | | --- | --- | | A. | earn no more than the Treasury-bill rate on either security. |  |  |  | | --- | --- | | **B.** | pay less for the security that has higher risk. |  |  |  | | --- | --- | | C. | pay less for the security that has lower risk. |  |  |  | | --- | --- | | D. | earn more if interest rates are lower. | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 3 Hard Learning Objective: 01-03 Explain the economic functions of financial markets and how various securities are related to the governance of the corporation. Topic: Financial Markets and the Economy* |

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| 55. | The efficient market hypothesis suggests that \_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | active portfolio management strategies are the most appropriate investment strategies |  |  |  | | --- | --- | | **B.** | passive portfolio management strategies are the most appropriate investment strategies |  |  |  | | --- | --- | | C. | either active or passive strategies may be appropriate, depending on the expected direction of the market |  |  |  | | --- | --- | | D. | a bottom-up approach is the most appropriate investment strategy | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-04 Describe the major steps in the construction of an investment portfolio. Topic: The Investment Process* |

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| 56. | In a perfectly efficient market the best investment strategy is probably \_\_\_\_\_.      |  |  | | --- | --- | | A. | an active strategy. |  |  |  | | --- | --- | | **B.** | a passive strategy. |  |  |  | | --- | --- | | C. | asset allocation. |  |  |  | | --- | --- | | D. | market timing. | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-04 Describe the major steps in the construction of an investment portfolio. Topic: The Investment Process* |

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| 57. | Market signals will help to allocate capital efficiently only if investors are acting \_\_\_\_\_.      |  |  | | --- | --- | | A. | on the basis of their individual hunches. |  |  |  | | --- | --- | | B. | as directed by financial experts. |  |  |  | | --- | --- | | C. | as dominant forces in the economy. |  |  |  | | --- | --- | | **D.** | on accurate information. | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-03 Explain the economic functions of financial markets and how various securities are related to the governance of the corporation. Topic: Financial Markets and the Economy* |

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| 58. | Which of the following is (are) true about hedge funds?  I. They are open to institutional investors. II. They are open to wealthy individuals. III. They are more likely than mutual funds to pursue simple strategies.      |  |  | | --- | --- | | **A.** | I and II only |  |  |  | | --- | --- | | B. | I and III only |  |  |  | | --- | --- | | C. | II and III only |  |  |  | | --- | --- | | D. | I, II, and III | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-04 Describe the major steps in the construction of an investment portfolio. Topic: The Investment Process* |

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| 59. | Venture capital is \_\_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | frequently used to expand the businesses of well-established companies |  |  |  | | --- | --- | | **B.** | supplied by venture capital funds and individuals to start-up companies |  |  |  | | --- | --- | | C. | illegal under current U.S. laws |  |  |  | | --- | --- | | D. | most frequently issued with the help of investment bankers | |

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| 60. | Individuals may find it more advantageous to purchase claims from a financial intermediary rather than directly purchasing claims in capital markets because:  I. Intermediaries are better diversified than most individuals II. Intermediaries can exploit economies of scale in investing that individual investors cannot III. Intermediated investments usually offer higher rates of return than direct capital market claims      |  |  | | --- | --- | | A. | I only |  |  |  | | --- | --- | | **B.** | I and II only |  |  |  | | --- | --- | | C. | II and III only |  |  |  | | --- | --- | | D. | I, II, and III | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 3 Hard Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Financial Intermediaries* |

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| 61. | Surf City Software Company develops new surf forecasting software. It sells the software to Microsoft in exchange for 1,000 shares of Microsoft common stock. Surf City Software has exchanged a \_\_\_\_\_ asset for a \_\_\_\_\_ asset in this transaction.      |  |  | | --- | --- | | A. | real; real |  |  |  | | --- | --- | | B. | financial; financial |  |  |  | | --- | --- | | **C.** | real; financial |  |  |  | | --- | --- | | D. | financial; real | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 62. | Stone Harbor Products takes out a bank loan. It receives $100,000 and signs a promissory note to pay back the loan over 5 years. In this transaction, \_\_\_\_\_.      |  |  | | --- | --- | | **A.** | a new financial asset was created |  |  |  | | --- | --- | | B. | a financial asset was traded for a real asset |  |  |  | | --- | --- | | C. | a financial asset was destroyed |  |  |  | | --- | --- | | D. | a real asset was created | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 63. | Which of the following firms was *not* engaged in a major accounting scandal between 2000 and 2005?      |  |  | | --- | --- | | **A.** | General Electric |  |  |  | | --- | --- | | B. | Parmalat |  |  |  | | --- | --- | | C. | Enron |  |  |  | | --- | --- | | D. | WorldCom | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-03 Explain the economic functions of financial markets and how various securities are related to the governance of the corporation. Topic: Financial Markets and the Economy* |

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| 64. | Accounting scandals can often be attributed to a particular concept in the study of finance known as the \_\_\_\_\_.      |  |  | | --- | --- | | **A.** | agency problem |  |  |  | | --- | --- | | B. | risk-return trade-off |  |  |  | | --- | --- | | C. | allocation of risk |  |  |  | | --- | --- | | D. | securitization | |

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| 65. | An intermediary that pools and manages funds for many investors is called \_\_\_\_\_\_.      |  |  | | --- | --- | | **A.** | an investment company |  |  |  | | --- | --- | | B. | a savings and loan |  |  |  | | --- | --- | | C. | an investment banker |  |  |  | | --- | --- | | D. | a commercial bank | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Financial Intermediaries* |

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| 66. | Financial institutions that specialize in assisting corporations in primary market transactions are called \_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | mutual funds |  |  |  | | --- | --- | | **B.** | investment bankers |  |  |  | | --- | --- | | C. | pension funds |  |  |  | | --- | --- | | D. | globalization specialists | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Financial Intermediaries* |

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| 67. | When a pass-through mortgage security is issued, what does the issuing agency expect to receive?      |  |  | | --- | --- | | A. | The amount of the original loan plus a servicing fee |  |  |  | | --- | --- | | B. | The principal and interest that are paid by the homeowner |  |  |  | | --- | --- | | **C.** | The principal and interest that are paid by the homeowner, minus a servicing fee |  |  |  | | --- | --- | | D. | The interest paid by the homeowner, plus a servicing fee | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-06 Explain the causes and consequences of the financial crisis of 2008. Topic: The Financial Crisis of 2008* |

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| 68. | In 2008 the largest corporate bankruptcy in U.S. history involved the investment banking firm of \_\_\_\_\_\_.      |  |  | | --- | --- | | A. | Goldman Sachs |  |  |  | | --- | --- | | **B.** | Lehman Brothers |  |  |  | | --- | --- | | C. | Morgan Stanley |  |  |  | | --- | --- | | D. | Merrill Lynch | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-06 Explain the causes and consequences of the financial crisis of 2008. Topic: The Financial Crisis of 2008* |

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| 69. | The inability of shareholders to influence the decisions of managers, despite overwhelming shareholder support, is a breakdown in what process or mechanism?      |  |  | | --- | --- | | A. | Auditing |  |  |  | | --- | --- | | B. | Public finance |  |  |  | | --- | --- | | **C.** | Corporate governance |  |  |  | | --- | --- | | D. | Public reporting | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-03 Explain the economic functions of financial markets and how various securities are related to the governance of the corporation. Topic: Financial Markets and the Economy* |

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| 70. | Real assets are \_\_\_\_\_\_.      |  |  | | --- | --- | | **A.** | assets used to produce goods and services |  |  |  | | --- | --- | | B. | always the same as financial assets |  |  |  | | --- | --- | | C. | always equal to liabilities |  |  |  | | --- | --- | | D. | claims on a company's income | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 1 Easy Learning Objective: 01-02 Distinguish between real assets and financial assets. Topic: Real Assets versus Financial Assets* |

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| 71. | A major cause of mortgage market meltdown in 2007 and 2008 was linked to \_\_\_\_\_\_\_\_.      |  |  | | --- | --- | | A. | private equity investments |  |  |  | | --- | --- | | **B.** | securitization |  |  |  | | --- | --- | | C. | negative analyst recommendations |  |  |  | | --- | --- | | D. | online trading | |

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| *AACSB: Analytic Blooms: Remember Difficulty: 2 Medium Learning Objective: 01-06 Explain the causes and consequences of the financial crisis of 2008. Topic: The Financial Crisis of 2008* |

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| 72. | In recent years the greatest dollar amount of securitization occurred for which type of loan?      |  |  | | --- | --- | | **A.** | Home mortgages |  |  |  | | --- | --- | | B. | Credit card debt |  |  |  | | --- | --- | | C. | Automobile loans |  |  |  | | --- | --- | | D. | Equipment leasing | |

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| 73. | Which of the following is (are) true about nonconforming mortgage loans?      |  |  | | --- | --- | | A. | They are also known as *subprime loans.* |  |  |  | | --- | --- | | B. | They have higher default risk than conforming loans. |  |  |  | | --- | --- | | C. | They were able to be offered without due diligence. |  |  |  | | --- | --- | | **D.** | All of these options are true. | |

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| 74. | The systemic risk that led to the financial crisis of 2008 was increased by \_\_\_\_\_.      |  |  | | --- | --- | | A. | collateralized debt obligations |  |  |  | | --- | --- | | B. | subprime mortgages |  |  |  | | --- | --- | | C. | credit default swaps |  |  |  | | --- | --- | | **D.** | all of the options | |

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| 75. | An investment adviser has decided to purchase gold, real estate, stocks, and bonds in equal amounts. This decision reflects which part of the investment process?      |  |  | | --- | --- | | **A.** | Asset allocation |  |  |  | | --- | --- | | B. | Investment analysis |  |  |  | | --- | --- | | C. | Portfolio analysis |  |  |  | | --- | --- | | D. | Security selection | |

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