Chapter 2: Financial Markets and Financial Instruments

Name: ____

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

1) Financial markets only involve buyers and sellers of financial instruments.

2) A college education can be considered an investment.

3) When calculating a holding period of return, dividends are excluded.

4) Stock prices are based upon the future value of cash flows.

5) Bond prices are indexed relative to 100.

6) The current yield of a bond is the rate of return on a bond if you hold it until maturity.

7) Interest expense is tax deductible but dividends are not.

8) More shares are traded on the Nasdaq on a daily basis than the NYSE.

9) A market maker is someone who works for someone wanting to sell her stock.

10) A bond with a rating of AA is better than a bond rated AAA.

11) As interest rates decline, the prices of outstanding bonds rise.

12) The return on commercial paper is guaranteed by the federal government.

13) Most stock trading occurs on the secondary market.

14) The bid price is the price a broker will give you for the stock you want to sell.

15) Forward contracts are easier to sell than a futures contract.

16) American hospitality companies really don't have to worry about foreign currency.

17) Insurance companies have decreased their loans to hospitality firms in recent years.

18) Futures contracts only are used with physical commodities.

19) The annual returns of the Dow Jones Industrial Average and the S&P 500 index are highly positively correlated.

20) We measure the uncertainty of an investment by its mean (average) return.

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

21) People invest
A) to make a lot of money.
B) so they can buy things now.
C) to increase future consumption.
D) to keep up with the times.

22) If a $1,000 bond is selling for 97, what is the selling price in dollars?
A) $970
B) $97
C) $1,030
D) $1,070

23) Assume you buy a share of stock for $20 and hold it for one year. During the year you receive $1.20 in dividends. At the end of the year you sell the stock for $19. What is your holding period return (pre-tax)?
A) 6.32%
B) 1%
C) 6.0%
D) 5.0%

24) What are the three factors that affect the present value of future cash flows?
A) timing, magnitude, and size
B) timing, magnitude, and risk
C) date cash flows are received, date stock was purchased, and taxes
D) type of cash flows, size of firm, and amount

25) Which of the following is considered to have the lowest risk?
A) an Aa bond from Hilton Hotels
B) a Ba bond from Cendant Corporation
C) commercial paper from McDonald’s
D) a treasury bill from the U.S. government

26) You currently hold a bond from Marriott International that pays you 8 percent. If interest rates rise the price of your bond will:
A) increase.
B) decrease.
C) only decrease if interest rates go above 8 percent.
D) be unchanged because the price depends on the risk of the company.

27) The first stock issue available to the public is called

A) a first sale.
B) secondary trading.
C) an IPO.
D) stock hedging.

28) A government agency involved in the secondary mortgage market is
A) FDIC.
B) Fannie Mae.
C) GAO.
D) IRS.

29) The best way for a large hospitality firm to hedge a price increase in a commodity would be to
A) do nothing and hope the price will decrease.
B) dramatically increase the price on your menu.
C) buy a futures contract.
D) buy a lot of the product now from a local purveyor with a lot of cash.

30) How can we get out of a futures contract?
A) Take an equal and opposite position in another contract.
B) Just let the contract expire.
C) Sell the contract.
D) Both a and c.

31) You run a hotel in Belgium that is owned by an American company. If the Euro strengthens against the dollar, your converted dollar profits will be
A) higher.
B) lower.
C) the same because we report our profits in Euros.
D) can't tell from information given.

32) You manage a McDonald's in Germany. At the beginning of the year, the exchange rate was $1 = 1Euro. At the end of the year, the exchange rate is $1 = .90Euro. You report profits of 450,000 Euros. How much have your profits increased in terms of dollars from the exchange rate change during the year?
A) 10%
B) 90%
C) 11.11%
D) unkown from information given

33) Given a two-year loan of $50,000 and an annual interest rate of 8 percent, how much interest will accrue during the life of the loan? (Assume no principal payments during the term.)
A) $4,000
B) $8,000
C) $400

D) None of the above

34) A measure of uncertainty in stock returns is
A) weighted average.
B) mean.
C) correlation coefficient.
D) standard deviation.

35) You own the following portfolio of stocks that have achieved the following returns.

Stock	Percentage of Portfolio	Return Percentage
A	25%	8%
B	65%	4%
C	10%	-5%

The weighted average return is
A) approximately 4.33 percent.
B) approximately 4.10 percent.
C) approximately 2.33 percent.
D) approximately 33 percent.

36) An 81/2 09 bond is currently selling for 102.50. The principal amount is $1,000. The current yield on the bond is
A) 8.5 percent.
B) 9 percent.
C) 8.29 percent.
D) none of the above.

ANSWER KEY—Chapter 2: Financial Markets and Financial Instruments

1) FALSE
2) TRUE
3) FALSE
4) FALSE
5) TRUE
6) FALSE
7) TRUE
8) TRUE
9) FALSE
10) FALSE
11) TRUE
12) FALSE
13) TRUE
14) FALSE
15) FALSE
16) FALSE
17) TRUE
18) FALSE
19) TRUE
20) FALSE
21) C
22) A
23) B
24) B
25) D
26) B
27) C
28) A, B
29) C
30) D
31) A
32) C
33) B
34) D
35) B
36) D