

Finance Review Questions

Chapter 6

1. Securities with maturities of one year or less are classified as
 - a. capital market instruments.
 - b. money market instruments.
 - c. preferred stock.
 - d. none of the above
2. Which of the following is not a money market security?
 - a. Treasury bill
 - b. negotiable certificate of deposit
 - c. common stock
 - d. federal funds
3. ____ are sold at an auction at a discount from par value.
 - a. Treasury bills
 - b. Repurchase agreements
 - c. Banker's acceptances
 - d. Commercial paper
4. Jarrod King, a private investor, purchases a Treasury bill with a \$10,000 par value for \$9,645. One hundred days later, Jarrod sells the T-bill for \$9,719. What is Jarrod's expected annualized yield from this transaction?
 - a. 13.43 percent
 - b. 2.78 percent
 - c. 10.55 percent
 - d. 2.80 percent
 - e. none of the above
5. Ignoring transaction costs, the cost of borrowing with commercial paper is equal to:
 - a. the yield on T-bills of the same maturity.
 - b. the yield earned by investors holding the paper until maturity.
 - c. the federal funds rate.
 - d. the par value of the paper.
6. LIBOR is:
 - a. the interest rate charged on international interbank loans.
 - b. the average rate charged on commercial loans in Europe.
 - c. the rate charged by the Federal Reserve for loans to banks.
 - d. the rate charged by the European Central Bank for loans to banks.
7. The LIBOR scandal in 2012 involved:
 - a. banks reporting inflated earnings from their loans.
 - b. hackers breaking into the loan documentation files.
 - c. banks falsely reporting the interest rates they offered in the interbank market.
 - d. collusion among the banks when setting the commercial paper.

8. Credit guarantees for commercial paper:
 - a. ensures that the issuer of commercial paper will use the funds obtained to provide credit.
 - b. are issued by the Federal Reserve Bank of New York.
 - c. **are only as good as the credit of the guarantor.**
 - d. A and C

9. The money market interest rate paid by corporations that borrow short-term funds in a particular country is typically:
 - a. **equal to the rate paid by that country's government.**
 - b. slightly higher than the rate paid by that country's government.
 - c. mostly influenced by the demand for and supply of long-term funds in that country.
 - d. set by the country's central bank.

10. Freeman Corp., a large corporation, plans to issue 45-day commercial paper with a par value of \$3,000,000. Freeman expects to sell the commercial paper for \$2,947,000. Freeman's annualized cost of borrowing is estimated to be ____ percent.
 - a. **14.39**
 - b. 14.13
 - c. 14.59
 - d. 14.33
 - e. none of the above

Chapter 7

1. ____ require the owner to clip coupons attached to the bonds and send them to the issuer to receive coupon payments.
 - a. **Bearer**
 - b. Registered
 - c. Treasury
 - d. Corporate

2. The yield to maturity is the annualized discount rate that equates the future coupon and principal payments to the initial proceeds received from the bond offering.
 - a. **True**
 - b. False

3. Note maturities are usually ____, while bond maturities are _____.
 - a. **less than 10 years; 10 years or more**
 - b. 10 years or more; less than 10 years
 - c. less than 5 years; 5 years or more
 - d. 5 years or more; less than 5 years

4. Investors in Treasury notes and bonds receive ____ interest payments from the Treasury.
 - a. annual
 - b. **semiannual**
 - c. quarterly
 - d. monthly

5. The Treasury has relied heavily on ____-year bonds to finance the U.S. budget deficit.
- 50
 - 70
 - 10
 - 5
6. Treasury bond dealers
- quote an ask price for customers who want to sell existing Treasury bonds to the dealers.
 - profit from a very wide spread between bid and ask prices in the Treasury securities market.
 - may trade Treasury bonds among themselves.
 - make a primary market for Treasury bonds.
7. Under the STRIP program created by the Treasury, stripped securities are created and sold by the Treasury.
- True
 - False
8. A ten-year, inflation-indexed bond has a par value of \$10,000 and a coupon rate of 5 percent. During the first six months since the bond was issued, the inflation rate was 2 percent. Based on this information, the coupon payment after six months will be \$_____.
- 250
 - 255
 - 500
 - 510
9. Bonds issued by ____ are backed by the federal government.
- the Treasury
 - AAA-rated corporations
 - state governments
 - city governments
10. Municipal general obligation bonds are _____. Municipal revenue bonds are _____.
- supported by the municipal government's ability to tax; supported by the municipal government's ability to tax
 - supported by the municipal government's ability to tax; supported by revenue generated from the project
 - always subject to federal taxes; always exempt from state and local taxes
 - typically zero-coupon bonds; typically zero-coupon bonds

11. In general, variable-rate municipal bonds are desirable to investors who expect that interest rates will ____.
- remain unchanged
 - fall
 - rise
 - none of the above
12. Which of the following statements is not true regarding zero-coupon bonds?
- They are issued at a deep discount from par value.
 - Investors are taxed on the total amount of interest earned at maturity.
 - The issuing firm is permitted to deduct the amortized discount as interest expense for federal income tax purposes, even though it does not pay interest until maturity.
 - Zero-coupon bonds are purchased mainly for tax-exempt investment accounts, such as pension funds and individual retirement accounts.
 - All of the above are true.

Chapter 8

1. The appropriate discount rate for valuing any bond is the
- bond's coupon rate.
 - bond's coupon rate adjusted for the expected inflation rate over the life of the bond.
 - Treasury bill rate with an adjustment to include a risk premium if one exists.
 - yield that could be earned on alternative investments with similar risk and maturity.
2. The valuation of bonds is generally perceived to be ____ the valuation of equity securities.
- more difficult than
 - easier than
 - just as difficult as
 - none of the above
3. A bond with a \$1,000 par value has an 8 percent annual coupon rate. It will mature in 4 years, and annual coupon payments are made at the end of each year. Present annual yields on similar bonds are 6 percent. What should be the current price?
- \$1,069.31
 - \$1,000.00
 - \$9712
 - \$927.66
 - none of the above
4. A bond with a ten percent coupon rate bond pays interest semi-annually. Par value is \$1,000. The bond has three years to maturity. The investors' required rate of return is 12 percent. What is the present value of the bond?
- \$1,021
 - \$1,000
 - \$981
 - \$951
 - none of the above

5. A bond with a 12 percent quarterly coupon rate has a yield to maturity of 16 percent. The bond has a par value of \$1,000 and matures in 20 years. Based on this information, a fair price of this bond is \$____.
- 1,302
 - 763
 - 761**
 - 1,299
6. From the perspective of investing institutions, the most attractive foreign bonds offer a ____ and are denominated in a currency that ____ over the investment horizon.
- high yield; appreciates**
 - high yield; remains stable
 - low yield; appreciates
 - low yield; depreciates
7. The value of ____-risk securities will be relatively ____.
- high; high
 - high; low**
 - low; low
 - none of the above
8. The larger the investor's ____ relative to the ____, the larger the ____ of a bond with a particular par value.
- discount rate; required rate of return; discount
 - required rate of return; discount rate; discount**
 - required rate of return; discount rate; premium
 - none of the above
9. If the coupon rate equals the required rate of return, the price of the bond
- should be above its par value.
 - should be below its par value.
 - should be equal to its par value.**
 - is negligible.
10. When financial institutions expect interest rates to ____, they may ____.
- increase; sell bonds and buy short-term securities**
 - increase; sell short-term securities and buy bonds
 - decrease; sell bonds and buy short-term securities
 - B and C
11. For a given par value of a bond, the higher the investor's required rate of return is above the coupon rate, the
- greater is the premium on the price.
 - greater is the discount on the price.**
 - smaller is the premium on the price.
 - smaller is the discount on the price.

12. Zero coupon bonds with a par value of \$1,000,000 have a maturity of 10 years, and a required rate of return of 9 percent. What is the current price?
- a. \$363,212
 - b. \$385,500
 - c. \$422,400
 - d. \$424,100
 - e. none of the above
13. If the coupon rate ____ the required rate of return, the price of a bond ____ par value.
- a. equals; equals
 - b. exceeds; is less than
 - c. is less than; is greater than
 - d. B and C
 - e. none of the above

Chapter 9

1. Mortgage-backed securities are commonly contained within collateralized debt obligations.
- a. True
 - b. False
2. Federally insured mortgages guarantee
- a. loan repayment to the lending financial institution.
 - b. that the interest rate will not increase during the life of the mortgage.
 - c. the lending financial institution a selling price for the mortgage in the secondary market.
 - d. all of the above
3. At a given point in time, the interest rate offered on a new fixed-rate mortgage is typically ____ the initial interest rate offered on a new adjustable-rate mortgage.
- a. below
 - b. above
 - c. equal to
 - d. all of the above are very common
4. Mortgage prices would normally be expected to ____ when the interest rates ____, holding other factors constant.
- a. increase; increase
 - b. decrease; decrease
 - c. increase; decrease
 - d. none of the above
5. Collateralized mortgage obligations (CMOs) are generally perceived to have
- a. no prepayment risk but some default risk.
 - b. no prepayment risk and no default risk.
 - c. the same interest rate risk as money market securities.
 - d. a high degree of prepayment risk.

6. Mortgage prices are subject to
- interest rate risk.
 - credit risk.
 - prepayment risk.
 - all of the above.
7. During a weak economy, the credit risk to a financial institution from investing in mortgage-backed securities representing subprime mortgages is ____ than that of mortgage-backed securities representing prime mortgages.
- equal to
 - slightly less than
 - more than
 - substantially less than
8. ____ are backed by conventional mortgages.
- Ginnie Mae mortgage-backed securities
 - Federal Reserve mortgage-backed securities
 - Private-label pass-through securities
 - Shared appreciation pass-through securities
9. Which of the following is not a guarantor of federally insured mortgages?
- the Federal Housing Administration (FHA)
 - the Veteran's Administration (VA)
 - the Federal Deposit Insurance Corporation (FDIC)
 - all of the above are guarantors of federally insured mortgages
10. ____ economic growth will probably ____ the risk premium on mortgages and ____ the price of mortgages.
- Strong; increase; decrease
 - Strong; increase; increase
 - Weak; decrease; increase
 - Weak; increase; increase
 - Weak; decrease; decrease
11. A ____ mortgage allows borrowers to initially make small payments on the mortgage, which are then increased on a graduated basis over the first five to ten years; payments then level off from there on.
- balloon-payment
 - graduated-payment
 - shared-appreciation
 - growing-equity
 - none of the above