

The Investment Environment

Multiple Choice Questions

1. The material wealth of a society is a function of

- A. all financial assets.
- B. all real assets.
- C. all financial and real assets.
- D. all physical assets.

2. _____ are real assets.

- A. Land
- B. Machines
- C. Stocks and bonds
- D. Knowledge
- E. Land, machines, and knowledge

3. The means by which individuals hold their claims on real assets in a well-developed economy are

- A. investment assets.
- B. depository assets.
- C. derivative assets.
- D. financial assets.
- E. exchange-driven assets.

4. _____ are financial assets.

- A. Bonds
- B. Machines
- C. Stocks
- D. Bonds and stocks
- E. Bonds, machines, and stocks

5. _____ financial asset(s).

- A. Buildings are
- B. Land is a
- C. Derivatives are
- D. U.S. agency bonds are
- E. Derivatives and U.S. agency bonds are

6. Financial assets

- A. directly contribute to the country's productive capacity.
- B. indirectly contribute to the country's productive capacity.
- C. contribute to the country's productive capacity both directly and indirectly.
- D. do not contribute to the country's productive capacity either directly or indirectly.
- E. are of no value to anyone.

7. In 2012, _____ was the most significant real asset of U.S. households in terms of total value.

- A. consumer durables
- B. automobiles
- C. real estate
- D. mutual fund shares
- E. bank loans

8. In 2012, _____ was the least significant financial asset of U.S. households in terms of total value.

- A. real estate
- B. mutual fund shares
- C. debt securities
- D. life insurance reserves
- E. pension reserves

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- A. real estate
- B. mutual fund shares
- C. debt securities
- D. life insurance reserves
- E. pension reserves

11. In 2012, _____ was the most significant liability of U.S. households in terms of total value.

- A. credit cards
- B. mortgages
- C. bank loans
- D. student loans
- E. other debt

12. Which of the following financial assets made up the greatest proportion of the financial assets held by U.S. households?

- A. Pension reserves
- B. Life insurance reserves
- C. Mutual fund shares
- D. Debt securities
- E. Personal trusts

13. In 2012 _____ of the assets of U.S. households were financial assets as opposed to tangible assets.

- A. 20.4%
- B. 34.2%
- C. 68.8%
- D. 71.7%
- E. 82.5%

14. The largest component of domestic net worth in 2012 was

- A. nonresidential real estate.
- B. residential real estate.
- C. inventories.
- D. consumer durables.
- E. equipment and software.

15. The smallest component of domestic net worth in 2012 was

- A. nonresidential real estate.
- B. residential real estate.
- C. inventories.
- D. consumer durables.
- E. equipment and software.

16. The national net worth of the U.S. in 2012 was

- A. \$15.411 trillion.
- B. \$26.431 trillion.
- C. \$42.669 trillion.
- D. \$48.616 trillion.
- E. \$70.983 trillion.

17. A fixed-income security pays

- A. a fixed level of income for the life of the owner.
- B. a fixed stream of income or a stream of income that is determined according to a specified formula for the life of the security.
- C. a variable level of income for owners on a fixed income.
- D. a fixed or variable income stream at the option of the owner.

18. A debt security pays

- A. a fixed level of income for the life of the owner.
- B. a variable level of income for owners on a fixed income.
- C. a fixed or variable income stream at the option of the owner.
- D. a fixed stream of income or a stream of income that is determined according to a specified formula for the life of the security.

19. Money market securities

- A. are short term.
- B. are highly marketable.
- C. are generally very low risk.
- D. are highly marketable and are generally very low risk.
- E. All of the options

20. An example of a derivative security is

- A. a common share of Microsoft.
- B. a call option on Intel stock.
- C. a commodity futures contract.
- D. a call option on Intel stock and a commodity futures contract.
- E. a common share of Microsoft and a call option on Intel stock.

21. The value of a derivative security

- A. depends on the value of the related security.
- B. is unable to be calculated.
- C. is unrelated to the value of the related security.
- D. has been enhanced due to the recent misuse and negative publicity regarding these instruments.
- E. is worthless today.

22. Although derivatives can be used as speculative instruments, businesses most often use them to

- A. attract customers.
- B. appease stockholders.
- C. offset debt.
- D. hedge risks.
- E. enhance their balance sheets.

23. Financial assets permit all of the following except

- A. consumption timing.
- B. allocation of risk.
- C. separation of ownership and control.
- D. elimination of risk.

24. The _____ refers to the potential conflict between management and shareholders.

- A. agency problem
- B. diversification problem
- C. liquidity problem
- D. solvency problem
- E. regulatory problem

25. A disadvantage of using stock options to compensate managers is that

- A. it encourages managers to undertake projects that will increase stock price.
- B. it encourages managers to engage in empire building.
- C. it can create an incentive for managers to manipulate information to prop up a stock price temporarily, giving them a chance to cash out before the price returns to a level reflective of the firm's true prospects.
- D. All of the options

26. Which of the following are mechanisms that have evolved to mitigate potential agency problems?

- I) Using the firm's stock options for compensation
- II) Hiring bickering family members as corporate spies
- III) Boards of directors forcing out underperforming management
- IV) Security analysts monitoring the firm closely
- V) Takeover threats

- A. II and V
- B. I, III, and IV
- C. I, III, IV, and V
- D. III, IV, and V
- E. I, III, and V

27. Corporate shareholders are best protected from incompetent management decisions by

- A. the ability to engage in proxy fights.
- B. management's control of pecuniary rewards.
- C. the ability to call shareholder meetings.
- D. the threat of takeover by other firms.
- E. one-share/one-vote election rules.

28. Theoretically, takeovers should result in

- A. improved management.
- B. increased stock price.
- C. increased benefits to existing management of taken-over firm.
- D. improved management and increased stock price.
- E. All of the options

29. During the period between 2000 and 2002, a large number of scandals were uncovered. Most of these scandals were related to

- I) manipulation of financial data to misrepresent the actual condition of the firm.
- II) misleading and overly optimistic research reports produced by analysts.
- III) allocating IPOs to executives as a quid pro quo for personal favors.
- IV) greenmail.

- A. II, III, and IV
- B. I, II, and IV
- C. II and IV
- D. I, III, and IV
- E. I, II, and III

30. The Sarbanes-Oxley Act

- A. requires corporations to have more independent directors.
- B. requires the firm's CFO to personally vouch for the firm's accounting statements.
- C. prohibits auditing firms from providing other services to clients.
- D. requires corporations to have more independent directors and requires the firm's CFO to personally vouch for the firm's accounting statements.
- E. All of the options

31. Asset allocation refers to

- A. choosing which securities to hold based on their valuation.
- B. investing only in "safe" securities.
- C. the allocation of assets into broad asset classes.
- D. bottom-up analysis.

32. Security selection refers to

- A. choosing which securities to hold based on their valuation.
- B. investing only in "safe" securities.
- C. the allocation of assets into broad asset classes.
- D. top-down analysis.

33. Which of the following portfolio construction methods starts with security analysis?

- A. Top-down
- B. Bottom-up
- C. Middle-out
- D. Buy and hold
- E. Asset allocation

34. Which of the following portfolio construction methods starts with asset allocation?

- A. Top-down
- B. Bottom-up
- C. Middle-out
- D. Buy and hold
- E. Asset allocation

35. _____ are examples of financial intermediaries.

- A. Commercial banks
- B. Insurance companies
- C. Investment companies
- D. Credit unions
- E. All of the options

36. Financial intermediaries exist because small investors cannot efficiently

- A. diversify their portfolios.
- B. assess credit risk of borrowers.
- C. advertise for needed investments.
- D. diversify their portfolios and assess credit risk of borrowers.
- E. All of the options

37. _____ specialize in helping companies raise capital by selling securities.

- A. Commercial bankers
- B. Investment bankers
- C. Investment issuers
- D. Credit raters

38. Commercial banks differ from other businesses in that both their assets and their liabilities are mostly

- A. illiquid.
- B. financial.
- C. real.
- D. owned by the government.
- E. regulated.

39. In 2012, _____ was(were) the most significant financial asset(s) of U.S. commercial banks in terms of total value.

- A. loans and leases
- B. cash
- C. real estate
- D. deposits
- E. investment securities

40. In 2012, _____ was(were) the most significant liability(ies) of U.S. commercial banks in terms of total value.

- A. loans and leases
- B. cash
- C. real estate
- D. deposits
- E. investment securities

41. In 2012, _____ was(were) the most significant real asset(s) of U.S. nonfinancial businesses in terms of total value.

- A. equipment and software
- B. inventory
- C. real estate
- D. trade credit
- E. marketable securities